



JERRY SANDERS
MAYOR

September 4, 2007

Mr. Kelly C. Bowers
Senior Assistant Regional Director
Securities and Exchange Commission
Los Angeles Regional Office
5670 Wilshire Boulevard, 11th Floor
Los Angeles, CA 90036-3648

Dear Mr. Bowers:

This is in response to your July 23, 2007 letter to Messrs. John Hartigan and Stanley Keller regarding Mr. Keller's "Initial Report of Independent Consultant" dated June 7, 2007.

Let me first assure the Securities and Exchange Commission (SEC) that I take the need to reform City government very seriously and this has been a top priority of mine ever since taking office nearly 20 months ago. To this end, there have been a number of initiatives I have already taken forward and that have been approved by the City Council. Many more are underway and will be brought forward as they are completed. Attachments 1 through 5 discuss the City's progress on implementing the recommendations found in the "Report of the Audit Committee" (Kroll Report) dated August 8, 2006.

Speaking specifically to the recommendations in Mr. Keller's report and noted in your letter:

1. **The City must finalize the internal audit function and hire as soon as possible a qualified internal auditor.**

The City concurs with this recommendation and is in the final stages of filling the internal auditor position. Interviews of seven finalists were held on July 26, 2007 and the top two candidates have been interviewed. A final decision and offer will be made shortly and an announcement made once an agreement for employment is reached. In the meantime, in May of this year I appointed a well-qualified Interim Internal Auditor who has re-activated the Internal Audit Unit, including the development of a City-wide risk assessment.

2. **The Audit Committee should complete its organization as quickly as possible by selecting citizen advisers and professional consultants, as necessary, to assist the Audit Committee in discharging its responsibilities.**

While Kroll recommended the establishment of an Audit Committee comprised of two "public" members and one City Council Member, the City Attorney has opined that this structure of an Audit Committee could not be implemented without a change to the City's Charter. As such, the City Council established an Audit Committee comprised of three City Council Members.

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Attachments 6 through 8 are the charter, ordinance establishing the Audit Committee, and statement of operating principles relating to the Audit Committee and its relationship with the Internal Auditor. In addition to the three City Council voting members, there are three ad hoc advisers confirmed at the July 30, 2007 Audit Committee meeting who will bring technical expertise to the Committee. The Audit Committee is also in the process of retaining a consultant with professional auditing and accounting expertise to assist the Audit Committee perform its oversight function.

On a parallel track, I established a 15 member City Charter Review Committee comprised of one member nominated by each Council Member and seven appointed by me. The charge of the Committee is to review a number of Charter related issues and ultimately submit recommended Charter amendments to the City Council. This is to be completed by September 2007 for consideration for inclusion on the June 2008 ballot. One of the items being discussed is to amend the Charter to establish a permanent Audit Committee, as well as suggesting the permanent make-up of the Committee.

3. **The City should upgrade to a more modern and reliable financial accounting system so as to ultimately improve financial reporting.**

The City concurs with this recommendation and has already selected a new software vendor. The current schedule calls for the implementation of a new core financial system by July 2008 and the human resources/payroll system by January 2009. This is moving as fast as can reasonably be expected.

4. **The City should re-evaluate the role and accountability of its Chief Financial Officer and consider having the same person serve as the Chief Financial Officer and Auditor and Comptroller.**

Upon taking office, I established the City's first ever Chief Financial Officer (CFO) position. As part of this action, I consolidated all financial related activities and responsibilities under this position. About one year after the establishment of this position, the City's Auditor and Comptroller left the City, providing the City with an opportunity to take those responsibilities and assign them specifically to the CFO. This is the first step in separating the internal audit responsibilities from the comptroller duties and is consistent with a recommendation made by Kroll. Again, because of an opinion by the City Attorney, this Kroll recommendation cannot be fully implemented without a Charter amendment and is also an item of discussion by the Charter Review Committee.

5. **The City should continue evaluating the disclosure process and consider whether moving toward a shelf-like disclosure system would be appropriate.**

The Independent Consultant's Report stated that "it will be desirable for the City to consider whether to move toward a more shelf-like disclosure system, similar to that used by private issuers, as a way to permit accessing the capital markets in a timely and efficient manner in order to achieve savings for taxpayers and ratepayers." The Independent Consultant made this suggestion in light of the comprehensive disclosure processes of the City's, including the Disclosure Controls and Procedures of the City's Disclosure Practices Working Group (the "DPWG") (Attachment 9). The City's current disclosure processes and procedures were enacted by Ordinance No. 0-19320 (Ordinance), adopted by the City Council on October 11, 2004. The

formation of the DPWG was in response to recommendations made by the law firm Vinson & Elkins L.L.P. in its report of September 16, 2004, regarding deficiencies in the processes and practices of the City with respect to the disclosure of financial information to the financial markets.

The DPWG is a cross-disciplinary internal working group of the City (currently composed of the City Attorney, the Chief Deputy City Attorney for Finance and Disclosure, City's Chief Financial Officer, the Debt Management Administrator, and the City's outside Disclosure Counsel, along with the City Council's Independent Budget Analyst as an ex-officio member)¹ designed to ensure communication between City departments, to create a clearinghouse to discuss and debate best practices with respect to disclosure controls and procedures, and to directly address the deficiencies cited in the Vinson & Elkins report. The objectives of the DPWG are twofold: to ensure the compliance of the City (and the City Council, City officers, and staff in the exercise of their official duties) with federal and state securities laws and to promote the highest standards of accuracy in disclosures relating to securities issued by the City.

The City is carefully reviewing the suggestion of the Independent Consultant, including the evaluation of so-called shelf-registration models currently in use by a limited number of public agencies that frequently access the public markets, especially if the current model is too cumbersome to ensure the timely process of documents as the City regains access to the public markets. The City has adopted improved procedures for the review of its Comprehensive Annual Financial Reports which can serve as the basis for such a shelf-registration process should it proceed in that direction. The City is mindful, however, that its current disclosure regime has made significant improvements to the City's controls regarding the release of financial information to the public capital markets. Accordingly, any shelf-registration model would take into consideration procedures currently in place which were designed to ensure that the City would not make misleading statements or omissions to the market place in the future.

In addition to the above, the City is moving forward on many fronts, including having issued its fiscal year 2003 and 2004 Comprehensive Annual Financial Reports, implementing additional Kroll remediation recommendations, working on strengthening its internal controls and filling key positions.

Sincerely,

Mayor Jerry Sanders

Enclosure: Attachments 1-9

Cc: Audit Committee/City Council
City Attorney
Chief Financial Officer
Independent Budget Analyst

¹ The current composition of the City's Disclosure Practices Working Group reflects the evaluation by the Independent Consultant. See the memorandum of the Independent Consultant, dated April 20, 2007 entitled "Memo of the Independent Consultant on the Disclosure Practices Working Group" attached hereto as Attachment 9. The City adopted the Independent Consultant's recommendation on April 30, 2007. The City expects to adopt an ordinance implementing changes to the DPWG in September 2007.



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THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: August 29, 2007

IBA Report Number: 07-80

City Council Docket Date: September 4, 2007

Item Numbers: 332 and 333

Item: Background Information for Item 332 - Report from the Independent Consultant (Stanley Keller) and Item 333 - Response to the SEC

RECAP OF INDEPENDENT CONSULTANT/MONITOR CONTRACT

The purpose of this report is to provide background information for Council and the public with respect to two items on next week's docket that relate to the status of the City's financial reforms. The first item, Item 332, is an information report from Stanley Keller in his capacity as the City's **Independent Consultant** as required by the Securities and Exchange Commission (SEC) in their Order of November 14, 2006. The SEC required that the City retain an Independent Consultant for a period of three years to review and make recommendations regarding the City's policies and internal controls with respect to its financial disclosure functions. A three year contract with Mr. Keller was recommended by the Mayor and approved by Council on January 16, 2007.

This contract also provided for Mr. Keller to serve in the capacity of "**Monitor**" as recommended by the Kroll report that was issued on August 8, 2006. In his role as Monitor, Mr. Keller is to assist with review and implementation of remediation measures as recommended by Kroll. While there is natural overlap between Independent Consultant and Monitor duties, it is important that they be distinct in their execution. Given the crossover of issues, the intent of Mr. Keller serving in both roles was to take advantage of knowledge he has acquired about San Diego's reform efforts in order to achieve efficiencies.

INITIAL REPORT OF INDEPENDENT CONSULTANT TO THE CITY OF SAN DIEGO (Item 332)

The SEC Order calls for the designated Independent Consultant to issue three reports to the SEC as follows: "issue its first report within 120 days after the date of the engagement and the following two reports within 60 days following each subsequent one-year period from the date of engagement." With Mr. Keller's contract with the City

Office of Independent Budget Analyst

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being executed on or about January 27, 2007, his first report, using that date, was due to the SEC on May 28, 2007. However, Mr. Keller requested of the SEC, and the SEC approved, an extension to June 8, 2007. Mr. Keller indicated he requested an extension in order to allow for items that were underway to be finalized and reflected in the report. Future requests for extension should first be approved by the Mayor and City Council.

Mr. Keller issued his report to the City Council, the Mayor's Office and the City Attorney as well as to the SEC on June 7, 2007. As Mr. Keller did not present his report to the City Council upon its release, this item is docketed so that he can discuss his report in a public forum and respond to questions.

LETTER FROM SEC IN RESPONSE TO THE INDEPENDENT CONSULTANT'S INITIAL REPORT (Item 333)

On Monday, July 23, 2007 Stanley Keller, Independent Consultant, and John Hartigan, the City's outside legal counsel on this matter, received a letter from Kelly C. Bowers, SEC Senior Assistant Regional Director, in response to the Independent Consultant's June 7th Initial Report. Mr. Keller provided the letter to the CFO and the City Attorney's Office the same day he received it, and he suggested that it be provided to the Chair of the Audit Committee. The correspondence was not similarly distributed to the Council President, members of the City Council or the IBA on the 23rd. It was provided to the Chair of the Audit Committee at the end of the week and to the City Council on Monday, July 30th. Timely distribution of important SEC communications is critical to both branches of government, and responsibilities for this should be clarified for the future.

The letter from the SEC requested that additional information be provided on the steps taken by the City to adopt the following items discussed in Mr. Keller's report:

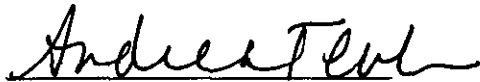
- Finalizing the internal audit function and hiring a qualified internal auditor
- Completing the organization of the Audit Committee and selecting citizen advisors and professional consultants to advise them
- Upgrading to a new financial accounting system
- Reevaluating the roles and accountability of the CFO and the Auditor and Comptroller
- Evaluating the disclosure process and consider moving to a shelf-like disclosure system

The letter stated: "please advise us as soon as possible as to the steps taken by the City to adopt the above recommendations or other alternative methods designed to achieve the same objectives... We are also interested in knowing the estimated timeframe for implementing these recommendations."

Since the letter was addressed to Messrs. Keller and Hartigan, I asked Mr. Keller to clarify whether the response should come from him or directly from the City. Mr. Keller noted that the City should be responding directly "since it is the City's response to my (Mr. Keller's) recommendations." At a special Audit Committee meeting of August 6th, the CFO discussed several points that he suggested be included in a City response. It was also noted at this meeting that this item would be scheduled for full Council discussion on September 4th, 2007 - the first Council meeting following legislative recess. In a letter sent on August 7th, the CFO notified the SEC regarding this schedule. This item has been docketed in order to discuss and coordinate a City response.

The IBA believes that a coordinated response regarding steps taken and planned actions will best convey the City's commitment to be responsive to the items noted in the SEC letter of July 23rd, 2007.

This report is provided for information only.

A handwritten signature in cursive script, reading "Andrea Tevlin".

Andrea Tevlin
Independent Budget Analyst

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THE CITY OF SAN DIEGO

August 7, 2007

Mr. Kelly C. Bowers
Senior Assistant Regional Director
Securities and Exchange Commission
Los Angeles Regional Office
5670 Wilshire Boulevard, 11th Floor
Los Angeles, CA 90036-3648

Dear Mr. Bowers,

The City is in receipt of your July 23, 2007 letter to Messrs. John Hartigan and Stan Keller regarding Mr. Keller's "Initial Report of Independent Consultant" dated June 7, 2007 and is in the process of preparing a formal written response.

The City Council is on legislative recess for the month of August. The Mayor would like to formally meet with the Council prior to sending the City's response and has worked with the City Council President to docket the item for the September 4 Council meeting. The City's response will be sent shortly thereafter.


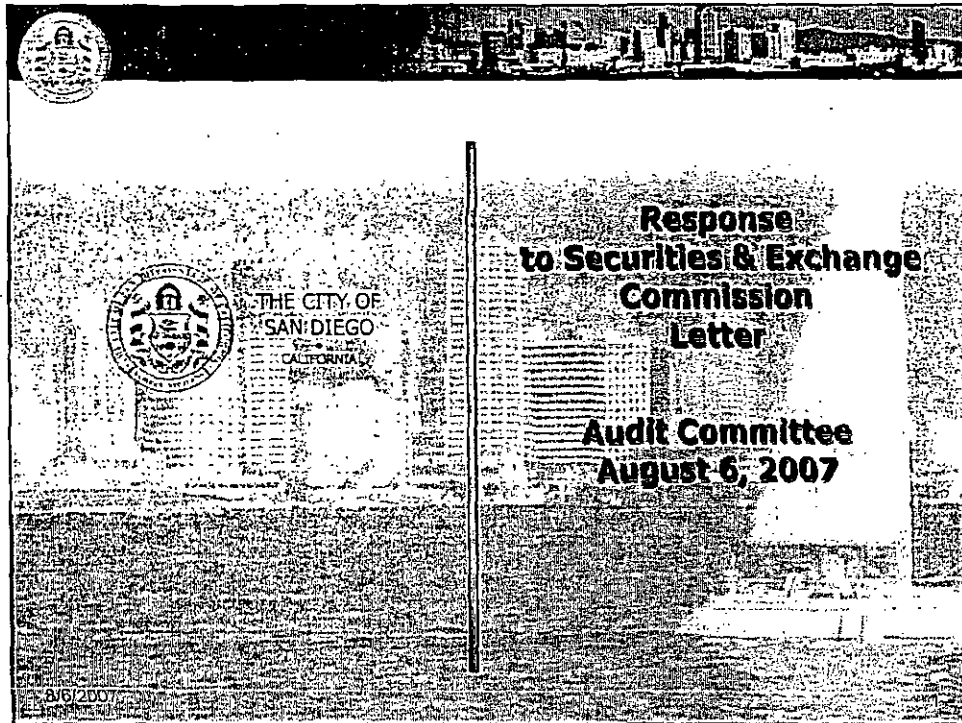
Should you have any questions in the meantime, feel free to contact me at 619-236-7080.

Thank you.

Sincerely,

Jay M. Goldstone
Interim Chief Operating Officer/Chief Financial Officer

Cc: Jerry Sanders, Mayor
City Council Audit Committee
City Councilmembers
Mike Aguirre, City Attorney
Stan Keller, Independent Consultant
Andrea Tevlin, Independent Budget Analyst



Overview

- Components of the response
- Timing of response
- Audit Committee's comments/input

8/6/2007

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The Response

- Describe work completed to date
- Provide the 6 Kroll remediation status reports
- Respond specifically to each of the 5 areas
- Acknowledge work still to be done

possible Council response

8/6/2007

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Internal Auditor

- The appointment of an Interim Internal Auditor
- Development of Risk Assessment
- Recruitment process
 - 19 applications
 - July 26th – 7 candidates interviewed
 - August – Top 2 candidates to be interviewed
 - Late August – Possible offer to be made

8/6/2007

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Audit Committee

- Acknowledge the establishment of a 3 Council Member Audit Committee
- July 30th Meeting – 3 technical experts added in an ex-officio capacity
- Apprise of work performed
- Share copy of Charter, Bi-laws and Statement of Operating Principles
- Mention work of Charter Review Committee

RFP - professional consultant



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Financial Accounting System

- Council approved the acquisition of SAP
- July 2008 – Implement Core Financial System
- January 2009 – Implement Payroll/HR System



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Role of Chief Financial Officer

- Establishment of the CFO position
- The consolidation of financial oversight
- Separation of the Internal Auditor from the Comptroller
- Work of the Charter Review Committee


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Disclosure Process

- Establishment of the Disclosure Practices Working Group (DPWG)
- Provide DPWG's Disclosure Controls & Procedures
- Cross-disciplinary internal working group
- City will take under advisement "shelf-like" disclosure system

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Next Steps

- Receive Audit Committee Comments
- Inform SEC of anticipated September response
- Present "final" letter to Council Sept. 4th
- Mail letter

8/6/2007

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OFFICE OF MAYOR JERRY SANDERS
CITY OF SAN DIEGO

MEMORANDUM

Date: October 5, 2006
To: Honorable Members of the City Council
From: Mayor Jerry Sanders *[Signature]*
Subject: Kroll Remediation Status for October 16, 2006, Council Meeting

In my memorandum dated August 24, 2006, I reported my staff had identified 121 items for remediation from the Kroll Report. These items were grouped by remedial category and were described in detail along with anticipated due dates. On October 16, 2006, my staff will meet with you to discuss the following:

- Status of remedial items identified for completion in September 2006 (items 1-6, 46-47, 48.ii, 84-86)
- Status of the implementation of the organizational structure for financial operations (addresses items 7-14)
- Additional remedial items identified (items 4.1, 20.1, 52.1, 52.2, 57.1, 107.1, 118.1, 120.1)

The numbering convention for the additional remedial items follows the remedial categories identified in my August 24, 2006, memorandum. For example, "new" item 4.1 matches the remedial category of Oversight Monitor and is most closely associated with item 4 from my prior memorandum.

Attachment A – Financial Operations Organizational Charts

Cc: City Attorney
BA
Chief Operating Officer
Chief Financial Officer
SDCERS
John Dyer

A. Completed Items**Remedial Category – City Actuarial Services**

46. The City should periodically, but no less frequently than every three years, retain its own actuary to review the SDCERS actuarial valuation and the assumptions used, and to provide an independent assessment of the valuation and its implications for the City. (Pages 260, M-11 & M-12)
47. The City must retain its own actuary responsible for determining for the City the cost of each proposed new retirement benefit and to issue a report thereon to the City Council before an ordinance is adopted conferring the benefit. (Pages 260 & M-12)

Status: Complete. The City has retained an actuary, Joseph Esuchanko. The City's actuary is nearly complete with his first report. The delay in his completion is the result of additional work assigned by the City in order to assist with the calculation of the City's Net Pension Obligation for the 2003 CAFR. Revised due date for the report is November 2006.

Remedial Category – Deferred Maintenance

48. We recommend that the Mayor and the Budget Director establish a process to identify and prioritize deferred maintenance and unfunded procurement needs. The Budget Director should prepare and present a public report identifying cumulative deferred maintenance and unfunded procurement needs during the annual budget hearings. The City's approach to funding deferred maintenance and unfunded procurement should be changed to allow for increased funding in these areas. (Page M-21)

In responding to this item, the Mayor's August 24, 2006, memorandum identifies four specific components (i, ii, iii and iv). Only items i and ii are addressed below.

- i. (48.i) Development of a Facility Category Index to identify facilities and assets critical to the mission of the City and prioritize those assets for funding to address deferred maintenance requirements.

Status: Complete. The due date indicated in my August 24, 2006, memorandum for this item should have been September 2006 instead of September 2007. This date was transposed with item 48.ii.

- ii (48.ii) Development of an asset inventory to create current inventories of essential infrastructure assets (e.g., Chiller Plants, Boilers, Pumps, High Voltage Switch Gear).

Status: Not complete. The due date for this item was misstated as September 2006. The correct due date is September 2007.

B. In Process Items**Remedial Category - Oversight Monitor**

1. Appoint a Monitor to oversee the implementation of and compliance with the Remediation Plan. (Pages 263 & M-14)
2. The Monitor should be selected by the Mayor in consultation with the City Council and subject to the approval of the SEC and should be an independent person of suitable standing, independence and experience for the assignment. (Pages 263 & M-14)
3. The Monitor should have complete and unfettered access to all City and SDCERS personnel and records. (Pages 263 & M-14)
4. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)
5. The Monitor should serve a term of no less than three years and should be provided adequate resources to carry the duties of his office. (Pages 263 & M-14)
6. The SEC should have the right, upon request, to expand the scope of the Monitor's duties following consultation with the City. (Pages 263 & M-14)

Status: In process. The appointment of an SEC approved Monitor is a recommendation that the Mayor supports. Further discussion with Council and the City Attorney's Office is needed to determine the term of retention and scope of duties. That discussion will occur prior to the November 13th, 2006, Council date, where a detailed presentation will be made.

Remedial Category – Reconciliation of Accounts

84. The City must develop an improved cash reconciliation process, which is more automated, documented, and complete. The revised process must support accuracy, timely completion, and improved ease of review. (Page M-16)
85. The City should develop and implement a timely and less cumbersome bank reconciliation process to clearly reconcile bank and the general ledger balances. The improved process should facilitate timely completion, ease of review, correction of errors, and enhance communication between the Comptroller's and Treasurer's staff. (Page M-16)

Status: In process. Cash for fiscal years 2003 and 2004 have been reconciled and reported to the City's external auditors. The establishment of a formal documented process will be complete by November 2006.

86. City Departments should reconcile all accounts receivable and deferred revenue accounts to supporting information at period ends. Supervisors should review these reconciliations for completeness and accuracy. (Page M-23)

Status: In process. This is a significant task requiring reconciliations by each City department with material revenue. The process documentation for reconciling accounts receivable and deferred revenue to supporting information for each period needs to be updated. Subsequently, appropriate City employees require training on the process. Finally, the processes (by department) need to be tested to confirm operating effectiveness. Revised completion date is June 2007.

II – Status of the Implementation of the Organizational Structure for Financial Operations

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Remedial Category – Organizational Structure

7. Centralize accountability for the accuracy and credibility of the City's financial reporting under the CFO. The areas of responsibility would include, a City Comptroller, a Director of Financial Reporting, the Financial Management Director, Director of Debt Management and City Treasurer. (Pages 245 & M-1)

Status: Completed: Prior to January 2006, the City's financial reporting structures were distributed throughout the organization. Some reported up to the City Manager through a Deputy and Assistant City Manager while the City Auditor & Comptroller, a separate department, reported to the Mayor and Council. This structure did not promote coordination, communications, accountability or transparency. One of the first changes I made upon taking office was to create the position of Chief Financial Officer (CFO) who is responsible for what I am calling the Department of Finance. The CFO is ultimately accountable for the accuracy and credibility of the City's financial reporting.

See organizational chart in Attachment A, 2006 Department of Finance. The City Comptroller (Auditor & Comptroller), Director of Financial Reporting (Financial Management), Director of Debt Management (Debt Management), and City Treasurer (Treasury) report directly to the CFO.

8. The Director of Planning, Budgeting and Financial Analysis (Financial Management Director) should report directly to the CFO and have principal responsibility for preparing an annual budget, a monthly budget with comparisons of budget to actual results year-to-date, analyses of variances and a quarterly report to the City Council and public setting forth budget versus actual results. (Pages 246 & M-2)

Status: Completed. The Financial Management Director reports directly to the CFO and has primary responsibility for preparing the annual budget. Quarterly reports have been provided to the City Council and public.

9. The City Treasurer should report to the CFO and have principal responsibility for all treasury functions for the City. (Pages 246 & M-2)
10. The CFO should have primary responsibility for, and have as direct reports, personnel with functional authority over accounting and financial analysis, treasury, planning and budgeting and financial reporting. This should include authority over those responsible for all information systems required by these functions. (Page M-1)
11. The Budget Director should report directly to the CFO and have principal responsibility for preparing an annual budget, a monthly budget with comparisons of budget to actual results year-to-date, analyses of variances, and a quarterly report to the City Council and public setting forth budgeted versus actual results. The Budget Director's Office should serve as a resource for financial analysis, planning assistance, and services to other City departments and agencies. (Page M-2)

II – Status of the Implementation of the Organizational Structure for Financial Operations

12. The City Treasurer should report to the CFO and have principal responsibility for all treasury functions for the City. The Office of the Treasurer and the duties assigned to that Office shall be as otherwise described in the City Charter. (Page M-2)

Status: Completed. The City Treasurer and the Budget Director report directly to the CFO. The CFO has authority over accounting and financial analysis, treasury, fiscal planning, budgeting and financial reporting and the systems that support these responsibilities. See organizational charts in Attachment A.

13. Establish the position of City Comptroller responsible for accounting and financial reporting, including preparation of the CAFRs and reporting to the CFO. (Pages 245, 246 & M-2)

14. Establish the position of Director of Financial Reporting responsible for the preparation of the City's periodic financial statements. (Pages 246 & M-2)

Status: The establishment of a Comptroller position will require a City Charter change. Anticipated ballot date is June 2008. Currently, the duties outlined for the Director of Financial Reporting are the shared responsibility of the Auditor & Comptroller and the Financial Management Director. More distinct delineation of duties will be established once the Director of Financial Reporting position has been created.

Since the delivery of my August 24, 2006, memorandum on "Responses to the Remedial Recommendations Found in the Kroll Report," staff has combed through the Kroll Report an additional time and has identified a number of additional recommendations. Most of these closely tie to remedial recommendations already identified and often provide some additional clarity. These additional items are discussed below. As discussed in my cover memorandum to this document, any number listed below that is a whole number (i.e., 4, 20, 52, etc.) reflect remedial recommendations previously identified. The other numbers that follow (i.e., 4.1, 20.1, 52.1, 52.2, etc.) represent newly reported items.

Remedial Category - Oversight Monitor

4. Original Item. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)

- 4.1. Additional Item. City Monitor quarterly reports should be made public in an appropriate manner including on the City's website. (Page M-14)

Response: After the City appoints a Monitor and receives quarterly reports on the progress of implementation, these reports will be made public on the City's website.

Remedial Category - Audit Committee, Formation and Duties

20. Original Item. The Audit Committee should establish a written charter. (Pages 251 & M-6)

- 20.1. Additional item. The City's Audit Committee should approve the annual compensation of the Auditor General and the annual budget for the Auditor General's staff. (Page M-5)

Response: Requires City Charter Change. Due date is June 2008.

Remedial Category - Disclosure

- 52 Original Item. The City Council should have at least two weeks to review substantially completed drafts of a preliminary offering statement before it is asked to vote to approve the final document. (Pages 263 & M-14)

- 52.1. Additional Item. The City Council members should also establish a reasonable period of time for the review of a final offering statement document, with marked changes from earlier drafts. (Page M-14)

- 52.2 Additional Item. The City CAFR is an integral component of the financial information provided as part of any debt issuance; the City Council should review and approve its use following the same procedures as offering statements. (Page M-14)

III – Additional Remedial Items Identified

Response: City Council should establish a reasonable period of time by December 31, 2006.

Remedial Category – Financial Reporting

57 **Original Item.** At year-end, a budget should be presented to the City Council containing a final budget-to-actual comparison, along with an explanation of variances by department. (Pages 262 & M-13)

57.1. **Additional Item.** Inter-departmental transfers to meet budget goals, or for any other purpose, should not be permitted unless approved in advance by the City Council. (Page M-13)

Response: It is staff's position that this has been implemented. First, the Appropriation Ordinance has been modified to remove the kind of flexibility to move funds around that were given the City Manager and Auditor and Comptroller in prior fiscal years. In addition, the City Council, through the Business Process Re-engineering (BPR) Ordinance still has the authority to review and take action on any and all movement of funds which result from BPRs prior to staff's processing any transfers. The City Council will be asked to approve the ultimate movement of funds via an amendment to the Appropriation Ordinance periodically throughout the fiscal year.

Remedial Category – City Funding of SDCERS

107 **Original Item.** The City and SDCERS should make a voluntary disclosure through a self-reporting process to the IRS of the amount of any improper diversion of funds used to pay retiree health care benefits and cooperate with the IRS to bring the City's retiree healthcare funding into full compliance. (Pages 259 & M-11)

107.1 **Additional Item.** Make early disclosure of such costs (retiree healthcare benefits) in its next issued financial statement. (Page M-11)

Response: While the City has not published the Net OPEB Obligation on its balance sheet, it has disclosed its actuarially developed liability in the transmittal letter of the fiscal year 2003 CAFR. It will do the same in all subsequent CAFRs and will begin reporting its Net OPEB Obligation in fiscal year 2008.

Remedial Category – SDCERS Board Structure

118 **Original Item.** Prior to any appointment, each potential appointee be required to complete a written application listing qualifications for the position and any factors that may impact on that decision, and that the applicants be required to affirm the accuracy of the application and a background check of the applicants should be done by the appropriate City department. (Pages 256 & M-9)

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118.1 Additional Item. SDCERS board applications should be shared with the Business and Governance Committee of the SDCERS board. (Page M-9)

Response: City staff will work with SDCERS.

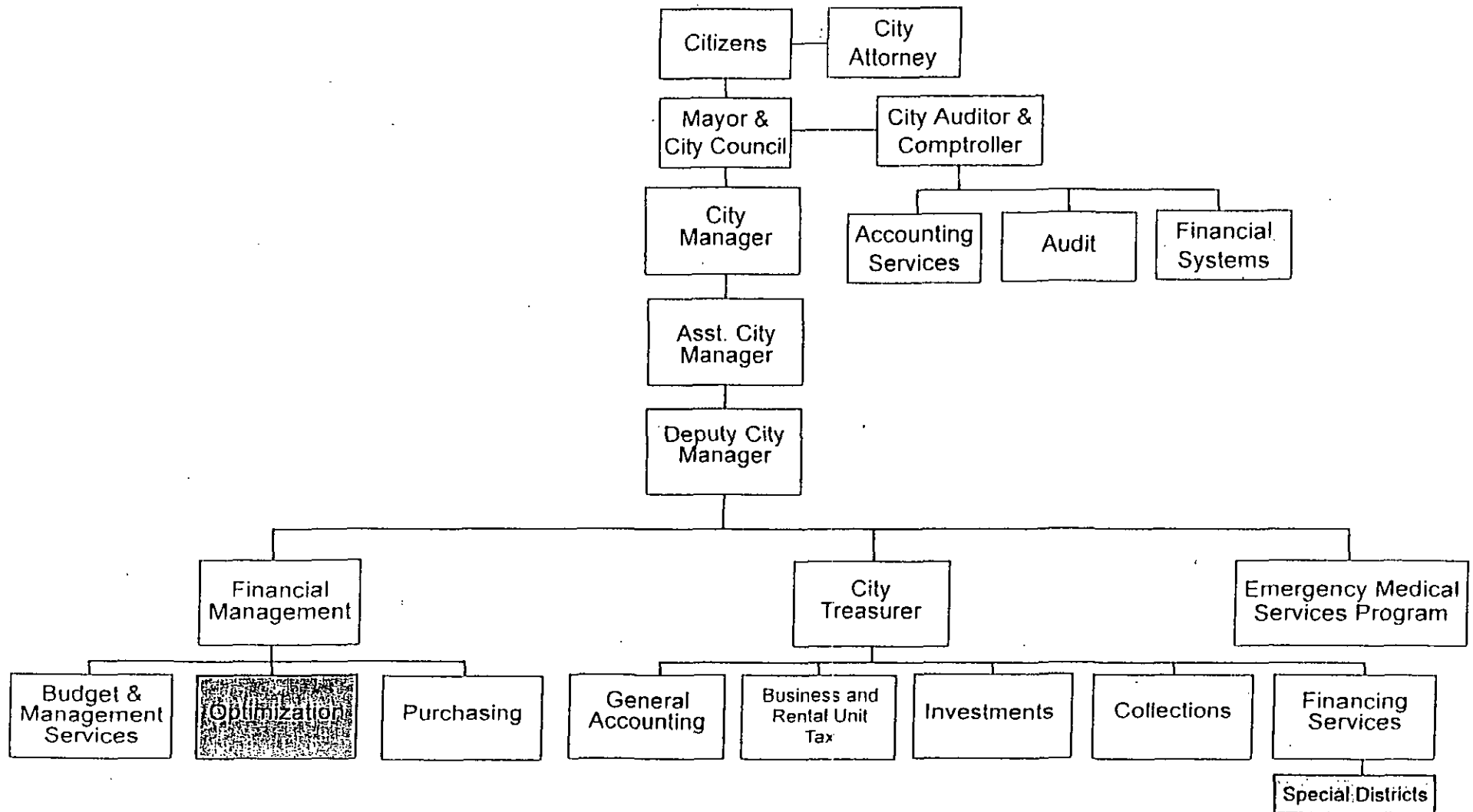
120 Original Item. SDCERS should adopt a formal charter for each committee which should be updated no less frequent than every three years. Pages 257 & M-9)

120.1 Additional Item. The annual SDCERS CAFR should include a report from each of its standing committees on significant activities during the year. (Page M-9)

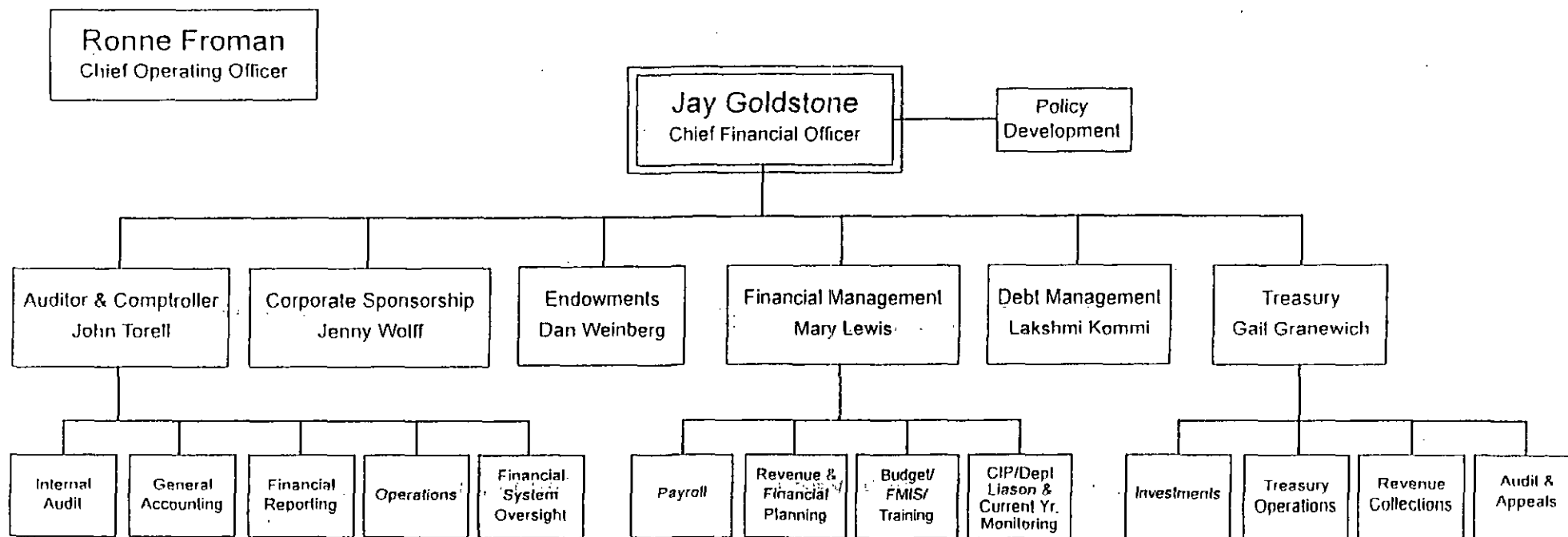
Response: Staff will work with SDCERS staff.

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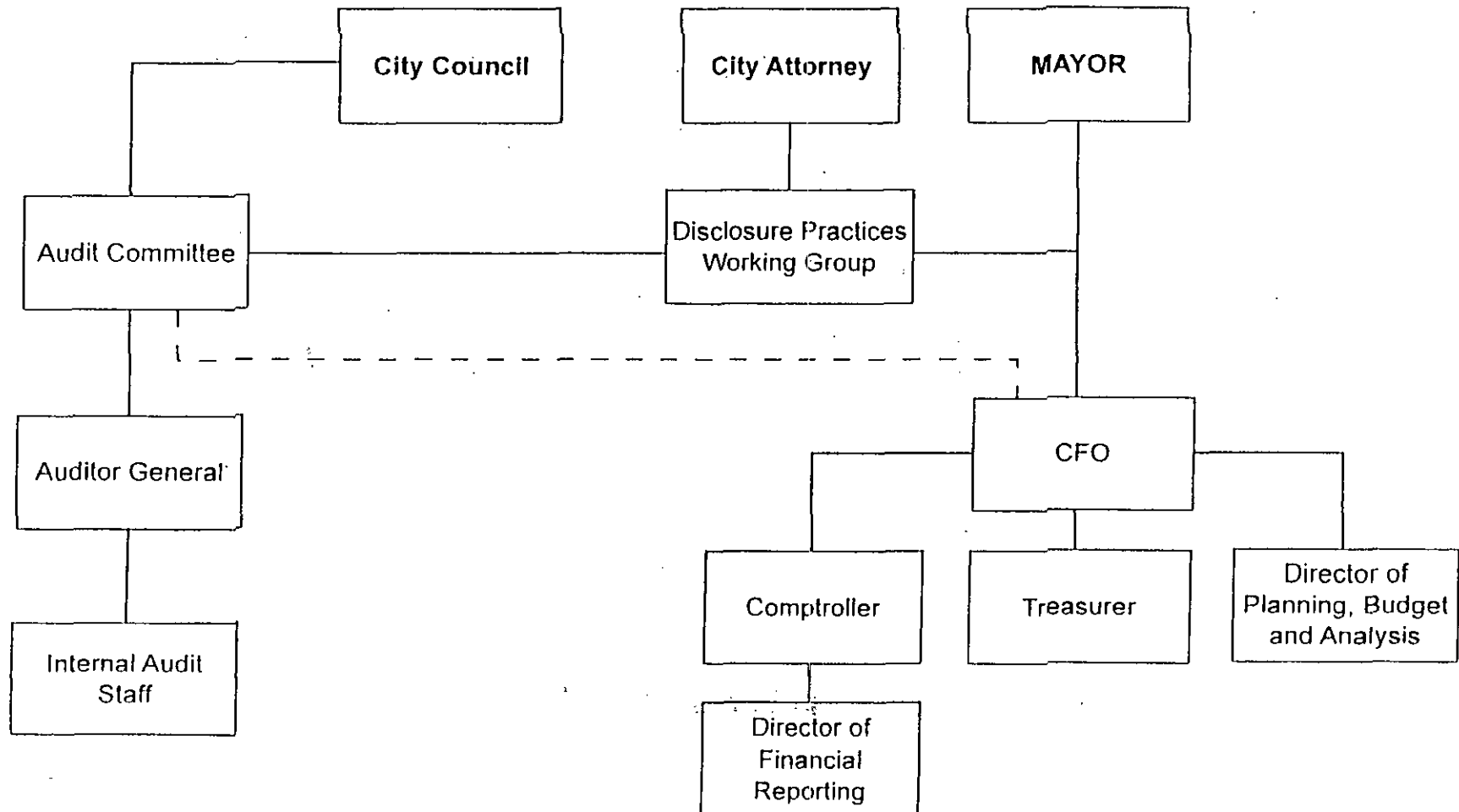


2006 DEPARTMENT OF FINANCE



APPENDIX N OF THE KROLL REPORT PROPOSED FINANCIAL REPORTING REORGANIZATION

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NOTE: Support to the Audit Committee would be provided by the CFO and Auditor General and their Staffs.

Attachment 1

Michael J. Aguirre

CITY ATTORNEY

MEMORANDUM OF LAW

DATE: January 23, 2006

TO: Honorable Mayor and City Councilmembers

FROM: City Attorney

SUBJECT: The Relationship Between the City Offices of the Mayor and the Auditor and Comptroller under the Mayor-Council Form of Government

QUESTION PRESENTED

What is the relationship between the Office of Auditor and Comptroller [Auditor] of the City of San Diego and the Office of the Mayor under the new Mayor-Council form of government?

SHORT ANSWER

Under the Mayor-Council form of government implemented January 1, 2006, the Mayor has the express authority to appoint and dismiss the Auditor. That places the office under the Mayor's supervision. However, the Mayor may not limit or impede the authority or duties given to, or required of, this public office by City Charter or ordinance, federal or state law.

BACKGROUND

On November 2, 2004, the voters of the City of San Diego passed Proposition F, which amended the San Diego City Charter to add Article XV to "test implementation of a new form of governance commonly known as a Strong Mayor form of government." Charter section 250. The five-year trial period of governance is operative January 1, 2006 and continues until December 1, 2010, unless the electorate extends this form of government. Charter § 255. Voters were urged "to elect a chief executive who is accountable for how the City is run, . . . who had the authority to make changes." San Diego Ballot Pamp. General Elec. Nov. 2, 2004, argument in favor of Prop. F.

Voters were told that "the Mayor would have the authority to give direction to all City officers and employees, except those in departments and offices recognized in the Charter as being independent . . . The Mayor would be responsible for preparing the annual budget for the

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Council's consideration and adoption. . . . The Mayor would appoint the City Manager with Council confirmation. The City Manager would serve at the pleasure of the Mayor. The Mayor would appoint the City Auditor and Comptroller, Police Chief, and Fire Chief, subject to Council confirmation. All other managerial department heads formerly under the City Manager would be appointed by the Mayor and serve at the pleasure of the Mayor." San Diego Ballot Pamp. General Elec. Nov. 2, 2004, the City Attorney's Impartial Analysis of Prop. F.

Part of the system of "checks and balances" created by Proposition F was the new office of Independent Budget Analyst. San Diego Ballot Pamp. General Elec. Nov. 2, 2004, argument in favor of Prop. F. The City Council would appoint the Independent Budget Analyst: "to review and provide budget information to the Council independent from the Mayor." San Diego Ballot Pamp. General Elec. Nov. 2, 2004, the City Attorney's Impartial Analysis of Prop. F.

Charter section XV was effective January 1, 2006, and with its implementation and the election of a new Mayor, questions have arisen about the relationship between the Office of the Mayor and the Office of the Auditor in the new form of governance.

DISCUSSION

I. Charter Changes Impacting the Auditor.

Effective January 1, 2006, the Mayor assumed all executive authority, power, and responsibilities conferred by the Charter upon the City Manager in Article V [Executive and Administrative Service], Article VII [Finance], and Article IX [Retirement of Employees]. Charter § 260 (b). In addition, the Mayor became the Chief Executive Officer of the City of San Diego.¹ Charter § 265 (b) (1).

A. The Mayor's Financial Duties.

The Mayor now serves as Chief Administrative and Chief Budget Officer of the City, assuming the duties and responsibilities of the previous City Manager. As such, the Mayor assumed the duties outlined in Charter section 28:

. . . to supervise the administration of the affairs of the City except as otherwise specifically provided in this Charter; to make such recommendation to the Council concerning the affairs of the City as may seem to him desirable; to keep the Council advised of the financial condition and future needs of the City; to prepare and submit to the Council the annual budget estimate and such reports as

¹ The Charter does not define "chief executive officer." But the title commonly means "The highest-ranking executive in a company or organization, responsible for carrying out the policies of the board of directors on a day-to-day basis." The American Heritage Dictionary of the English Language: Fourth Edition (2000). (<http://www.bartleby.com/61/90/C0289050.html>)

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may be required by that body, including an annual report of all the Departments of the City . . . as Chief Budget Officer of the City, [the Mayor] shall be responsible for planning the activities of the City government and for adjusting such activities to the finances available. To this end he shall *prepare annually a complete financial plan* for the ensuing year and shall be responsible for the administration of such a plan when adopted by the Council. He shall be charged with the *bringing together of estimates covering the financial needs of the City*, with the checking of these estimates against the information relative to past expenditures and income, with *the preparation of the budget document and supporting schedules and with the presentation of the budget to the Council.* (Emphasis added).

In addition, the Mayor is to cooperate fully with the Council and the Office of Independent Budget Analyst, including supplying requesting information concerning the budget process and fiscal condition of the city to the Council and the public. Charter § 265 (b)(14) (15).

B. Mayor's Supervision of Officers Responsible for Financial Matters.

With the broad administrative and fiscal responsibilities came the Mayor's authority to appoint and dismiss the City officers responsible for City financial matters. He may appoint and dismiss the City Treasurer as could the previous City Manager. Charter §§ 260 (b), 29, and 45. The amendments to the Charter made no changes in the duties and responsibilities of the office of the Treasurer, which include maintaining custody of and disbursing City moneys, and recording all receipts and expenditures. Charter § 45. Similarly, the Charter transferred the authority to appoint the Auditor from the City Council to the Mayor, subject to Council confirmation, and provides that the Mayor may remove the Auditor subject to appeal to the City Council. Charter §§ 265 (b)(10) and (11). However, the Charter made no changes to the duties of the Auditor. The Auditor remains the "chief fiscal officer of the City" according to Charter section 39, with all of the previously-existing duties and powers.

In assuming the responsibility for the proper administration of all affairs of the City, Charter section 29 gives the Mayor the power to appoint and remove:

. . . all officers and employees in the administrative service of the City under his control; but the [Mayor] may authorize the head of a Department or officer responsible to him to appoint and remove subordinates in such Department or office. Appointments made by, or under the authority of, the [Mayor], shall be on the basis of administrative ability and of the training and experience of such appointees in the work which they are to perform. All such appointments shall be without definite term unless for temporary service not to exceed sixty days. . . Charter § 29.

Under the new form of government, the Office of Auditor and Comptroller was expressly transferred to the new executive branch of City government and the officer holding the position

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of Auditor now reports to the highest ranking officer within that branch, the Mayor. However, the Auditor's independent duties, and powers under the City Charter and San Diego Municipal Code have not changed. To help ensure the Auditor's independence, the Charter provides a "checks and balances" by allowing the Auditor to appeal his removal to the City Council. Charter § 265 (b) (11). Nonetheless, the Mayor's responsibilities with respect to the City's finances and budget require that he exercise supervisory authority over the Auditor, subject to other laws that require the Auditor's independence when performing his or her duties.

II. The Auditor's Authority and Responsibilities Remain Unchanged.

The Office of Auditor is created by the City Charter and the Charter provides the City Council with only limited authority to transfer to others those matters the office might handle that "do not relate directly to the finances of the City." Charter § 39. Accordingly, the Department may not be changed, abolished, combined or rearranged except by a charter change. Similarly, no other Department may be created that would duplicate the duties the charter places upon the Auditor that do relate directly to the finances of the City. See, Charter § 26; *Hubbard v. City of San Diego*, 55 Cal.App.3d 380, 387-388 (1976).

In addition, the Mayor would exceed his authority should he impede the performance of the mandatory duties and responsibilities placed upon the Auditor as a public officer by the City Charter, ordinance, or state or federal law. See, *Lockyer v. City and County of San Francisco*, 33 Cal.4th 1055, 1079-1080 (2004). A Mayor in the new form of government only has the authority that is expressly or impliedly conferred upon him or her by a charter. 3 McQuillin, Mun. Corp. (3rd Ed, 2001) § 12.43, p. 266; see, *Bartlett v. Bell*, 58 Cal. App. 357 (1922) [Mayor has no power to compel Auditor to act in matter to benefit a third party].

The duties required of and the power provided to the City Auditor by the City Charter remain intact through the governance change. Charter section 39 specifies the duties of the Auditor and provides, in relevant part, that:

... The City Auditor and Comptroller shall be the chief fiscal officer of the City. He shall exercise supervision over all accounts, and accounts shall be kept showing the financial transactions of all Departments of the City upon forms prescribed by him and approved by the City Manager and the Council. He shall submit to the City Manager and to the Council at least monthly a summary statement of revenues and expenses for the preceding accounting period,² detailed as to appropriations and funds in such manner as to show the exact financial condition of the City and of each Department, Division and office thereof. No contract, agreement, or other obligation for the expenditure of public funds shall be entered into by any officer of the City and no such contract shall be valid unless the Auditor and Comptroller shall certify in writing that there has been

² Charter section 89 also requires the Auditor submit similar monthly statements to the Council.

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made an appropriation to cover the expenditure and that there remains a sufficient balance to meet the demand thereof.³ He shall *perform the duties imposed upon City Auditors and Comptrollers by the laws of the State of California, and such other duties as may be imposed upon him by ordinances of the Council*, but nothing shall prevent the Council from transferring to other officers matters in charge of the City Auditor and Comptroller which do not relate directly to the finances of the City. He shall prepare and submit to the City Manager such information as shall be required by the City Manager for the preparation of an annual budget. He shall appoint his subordinates subject to the Civil Service provisions of this Charter. (*Emphasis added*).

Other Charter-mandated duties include the joint determination with the City Attorney of the proper form, arrangement, and itemization of the annual appropriation ordinance; and determination of the "percentage change in price index" (Charter § 71); the keeping of accounts for each item of appropriation; and the transfer of unexpended funds from these accounts to the general fund upon completion of the project or at the end of one year. Charter § 72. If the Council fails to include adequate funds in the appropriation ordinance to cover the Mayor's estimate of the City's debt, or the amount actually required to cover the debt, the Charter requires the Auditor to set up an account for the full amount the Mayor estimates or the amount required to cover the debt, and to transfer tax revenue into that account. Charter § 74. The Auditor has the responsibility to examine all payrolls, bills and other claims against the city (except claims for damages) and has the discretionary authority to investigate such claims (Charter § 82); he is responsible for issuing the checks to pay claims against the City that have been approved by the heads of the Department or offices incurring the debt (Charter § 83); he receives reports from all City officials who collect and deposit money for fees, permits, licenses, inspections, services, taxes, and other municipal charges (Charter §§ 86 and 88); and he determines the appropriate form of accounts to be used by all officers and Departments of the city that receive or disburse City moneys (Charter § 87).

The Auditor must include in his records the cost or value of all City assets; present a balance sheet containing that information to the Mayor-Manager; and publish that information in his annual report. Charter § 112; SDMC § 22.0708. He must audit the accounts of any officer who dies, resigns or is removed from office, and report the results to the Mayor-Manager and Council. If the person is found indebted to the City, the Auditor must notify the Mayor and Council. Charter § 111. And the Auditor has authority to refuse to issue a warrant for a retirement allowance, if, in the Auditor's opinion, the allowance has been granted in contravention of Charter Article IX or ordinances passed under its authority. Charter § 144.

³ Charter section 80 also requires the Auditor first certify there are adequate unencumbered funds in the Treasury to cover any contract, agreement, or obligation involving the expenditure of funds before the Council makes such contracts or orders.

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The Auditor has additional responsibilities and powers codified in section 7, Article 2 of the San Diego Municipal Code. For example, the Auditor:


... shall, at any time, have power to examine, check and audit the accounts and records of any commission, board, department, division, office, or employee of the City; to require an accounting for all cash revenues of the City; to make and certify to an actual count of cash and securities, and to prescribe, govern and control the movements, or transfer of all cash revenues, or securities, to the custody of the City Treasurer." SDMC §22.0701.

The Mayor and the Auditor must jointly prepare and submit an annual report to the City Council and the Financial Reporting Oversight Board on the status of the City's internal financial controls, with the necessary joint certifications. SDMC § 22.0708. The Auditor also has separate duties associated with the City's Comprehensive Annual Financial Report (CAFR). SDMC §§ 22.0709, 22.0710. Accordingly, the Auditor has many responsibilities and duties outlined in the Charter, City ordinances, and state laws in addition to the reporting obligations to the Mayor and City Council.

CONCLUSION

Under the new Mayor-Council form of governance, the Auditor reports to the Mayor as Chief Executive Officer of the City of San Diego. Under the Charter, the Auditor is required to support the Mayor in his obligation to provide a budget to the City Council and to provide such other information related to the City's finances and the administration of the City. However, the Auditor does retain some independence in that the Mayor may not limit or impede the authority or duties given to or required of this public officer by Charter, ordinance, federal or state law. Finally, the Auditor's right to appeal his removal to the City Council provides a check and balance on any improper interference with the Auditor's duties and responsibilities.

Respectfully submitted,



MICHAEL J. AGUIRRE
City Attorney

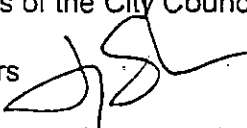
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**OFFICE OF MAYOR JERRY SANDERS
CITY OF SAN DIEGO**

MEMORANDUM

Date: October 30, 2006
To: Honorable Members of the City Council
From: Mayor Jerry Sanders 
Subject: Kroll Remediation Status for November 13, 2006, Council Meeting

In my memorandum dated August 24, 2006, I reported my staff had identified 121 items for remediation from the Kroll Report. These items were grouped by remedial category and were described in detail along with anticipated due dates. In my memorandum dated October 5, 2006, I updated you on the status of items due in September 2006. On November 13, 2006, my staff will meet with you to discuss the following:

- Status of remedial items completed as of November 13, 2006.
- Status of remedial items in-process but not complete as of November 13, 2006

Attachment A – Mayor's memorandum dated October 5, 2006, Kroll Remediation Status for October 16, 2006, Council Meeting

Attachment B – City Employee Waste, Fraud, Abuse and Ethics Hotline Policy and Procedures Manual (Draft)

Attachment C – Anonymous Submission of Suspected Wrongdoing (Whistleblowers) – Issues for Government Audit Committees to Consider (source: AICPA)

Attachment D – Interest Allocation Remedial Documentation

Cc: City Attorney
Chief Operating Officer
Chief Financial Officer
Independent Budget Analyst
SDCERS
John Dyer

A. Items Previously Reported Complete

Kroll Items 7-12, 46-47, 48(i), 57.1, 107.1 – see my memorandum dated October 5, 2006 (refer to Attachment A)

B. Items Completed During this Reporting Period**Remedial Category – Audit Committee – Formation and Duties**

24. The Audit Committee should have responsibility for the establishment and monitoring of effective policies and procedures for dealing with "whistleblower" complaints, including an internal hotline. (Pages 252 & M-6)

Status: Mayoral Office of Ethics and Integrity (OEI) task complete; awaiting meet and confer process results and formation of Audit Committee, see section II.B. The OEI has drafted a policy and procedures for the City's hotline process. Refer to Attachment B. In drafting the policy and procedures, the OEI used the American Institute of Certified Public Accountants (AICPA) tool kit for "Anonymous Submission of Suspected Wrongdoing (Whistleblowers) - Issues for Government Audit Committees to Consider." Refer to Attachment C.

The policy and procedures include protection for whistleblowers and meets the recommendations of Kroll Report item 24. The OEI is in the process of "meet and confer" with the City's unions regarding the policy and procedures manual. Once the Audit Committee is in place, the policy and procedures will be reviewed by the Committee and changed if necessary (after "meet and confer" with the unions).

Remedial Category – Budget Policies and Practices

45. The City should publish, along with the annual budget, the significant assumptions that can materially affect the budget, and a comparison of these assumptions against actual experience in recent years. (Pages 261 & M-12)

Status: Complete. The City's Fiscal Year (FY) 2007 budget is complete and will be distributed in November. Included in this document is a section that describes the assumptions used to develop the budget. As the City develops its first five-year financial plan, the projections for the current fiscal year will be frequently updated. This will provide a working tool for the City Council to compare budgeted assumptions to actual data.

The City of San Diego does not have actual data for FYs 2003-2005 to illustrate actual experience against the budget. In preparation of the FY 2008 budget and subsequent FY budgets, significant assumptions will be compared against actual experience for prior years.

I. Remedial Items Completed

Remedial Category – Financial Reporting

54. The City budget should be presented by month, by department. (Pages 261 & M-13)
55. At least quarterly, a report should be prepared reflecting budget-to-actual comparisons by department in aggregate, with an explanation of significant variances, to be disseminated to the public. (Pages 261 & M-13)
56. The City budget should present budget-to-actual comparisons by department, fiscal year-to-date, along with variances on a monthly basis. (Pages 261 & M-13)
57. At year-end, a budget should be presented to the City Council containing a final budget-to-actual comparison, along with an explanation of variances by department. (Pages 262 & M-13)

Status: Complete. The City budget by month, by department for the first two accounting periods was provided to the City Council and presented to the Budget and Finance Committee on October 18, 2006. This report also contains budget to actual comparisons and an explanation of significant variances. The report was made public on the City's website. A similar report will be published on a quarterly basis. Additionally, on September 13, 2006, The Fiscal Year 2006 Summary Report was presented to the City Council. This report contains a final budget-to-actual comparison, along with explanations of variances by department.

Remedial Category – Interest Allocation

74. The City must develop an improved cash reconciliation process, which is more automated, documented, and complete. The revised process must support accuracy, timely completion, and improved ease of review. (Page M-16)

Status: Complete (internal control operating effectiveness to be tested by March 31, 2007). A formal documented process has been completed. Documentation includes an internal control matrix, process flow, process narrative and identification of significant control activities. Additionally, remediation documentation contains a background discussion, actions taken for remediation, design effectiveness assessment, operating effectiveness assessment and process improvement recommendations. Refer to Attachment D. The CFO briefed Macias Ginni & O'Connell on the remediation documentation and received positive feedback.

Remedial Category – Reconciliation of Accounts

84. The City must develop an improved cash reconciliation process, which is more automated, documented, and complete. The revised process must support accuracy, timely completion, and improved ease of review. (Page M-16)

I. Remedial Items Completed

85. The City should develop and implement a timely and less cumbersome bank reconciliation process to clearly reconcile bank and the general ledger balances. The improved process should facilitate timely completion, ease of review, correction of errors, and enhance communication between the Comptroller's and Treasurer's staff. (Page M-16)

Status: Complete (internal control operating effectiveness to be tested by March 31, 2007). A formal documented process has been completed. Documentation includes an internal control matrix, process flow, process narrative and identification of significant control activities.

Additionally, remediation documentation contains a background discussion, actions taken for remediation, design effectiveness assessment, operating effectiveness assessment and process improvement recommendations.

II. Remedial Items In-Process

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A. Items In-Process Previously Reported

Kroll Items 1-6 and 86 – see my memorandum dated October 5, 2006 (refer to Attachment A).

There is no update to the status of Kroll item 86. Updated status for Kroll Items 1-6 is presented below.

Remedial Category - Oversight Monitor

1. Appoint a Monitor to oversee the implementation of and compliance with the Remediation Plan. (Pages 263 & M-14)
2. The Monitor should be selected by the Mayor in consultation with the City Council and subject to the approval of the SEC and should be an independent person of suitable standing, independence and experience for the assignment. (Pages 263 & M-14)
3. The Monitor should have complete and unfettered access to all City and SDCERS personnel and records. (Pages 263 & M-14)
4. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)
5. The Monitor should serve a term of no less than three years and should be provided adequate resources to carry the duties of his office. (Pages 263 & M-14)
6. The SEC should have the right, upon request, to expand the scope of the Monitor's duties following consultation with the City. (Pages 263 & M-14)

Updated Status: In process. Meetings are being scheduled with the Council and the City Attorney to discuss the Kroll recommended monitor. The Mayor will bring forward a monitor recommendation(s) as soon as possible but no later than January 31, 2007. The scope of duties, term of retention and qualifications will be consistent with the Kroll Report and any subsequent SEC order, if applicable. The Council will have the final approval over the term of retention, scope of duties and qualifications through approval of the contract entered into between the City and the monitor.

B. Items In-Process During this Reporting Period

Remedial Category – Audit Committee, Formation and Duties

18. The City should establish a three member Audit Committee comprised of two members from the public and one City Council Member. The public members would be nominated by the Mayor and confirmed by the City Council. (Pages 251 & M-6)

II. Remedial Items In-Process

19. The City's Financial Reporting Oversight Board should be eliminated as redundant to the Audit Committee. (Page M-6)
20. The Audit Committee should establish a written charter. (Pages 251 & M-6)
21. The Audit Committee should meet quarterly, or more often if necessary, with the City's independent auditors, the City's Auditor General and the CFO. (Page 252)
22. The Mayor, CFO, City Attorney, *Independent Budget Analyst (added)* and City Council should have the authority to make requests of the Audit Committee and Auditor General to perform internal audits of material matters they reasonably believe to be warranted. (Page 252)
23. With the assistance of the CFO and Auditor General, the City's independent auditors would be retained by, report to and take direction from the Audit Committee. (Page 252)
24. The Audit Committee should have responsibility for the establishment and monitoring of effective policies and procedures for dealing with "whistleblower" complaints, including an internal hotline. (Pages 252 & M-6)

Status: Long Term Plan – A City Charter change is required to fully meet all the Kroll Report Audit Committee recommendations identified above. The Mayor requests the City Council direct the City Attorney to prepare a proposed Charter change that will meet the Kroll Report recommendations. The proposed Charter change should be included in the June 2008 general election.

Short Term Plan – Until the above Charter change can be effectuated, the Mayor requests the City Council direct the City Attorney to amend the Municipal Code¹, using the Kroll Report language as modified below, to convert the Financial Reporting Oversight Board into the Advisory Audit Committee which will serve as an advisory board to the Mayor and City Council.

18. The City should establish a three member Audit Committee comprised of two members from the public and one City Council Member. The public members would be nominated by the Mayor and confirmed by the City Council. (Pages 251 & M-6) No change.
19. The City's Financial Reporting Oversight Board should be eliminated as redundant to the Audit Committee. (Page M-6) No change.
20. The Audit Committee should establish a written charter consistent with its role as an advisor to the Mayor and City Council. (Pages 251 & M-6)

¹ San Diego Municipal Code, Chapter 2: Government, Article 6: Board and Commissions, Division 17: Financial Reporting Oversight Board

II. Remedial Items In-Process

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21. The Audit Committee, in conjunction with the Mayor and City Attorney, should meet quarterly, or more often if necessary, with the City's independent auditors, the City's Auditor General and the CFO. (Page 252)
22. The Mayor, CFO, City Attorney, *Independent Budget Analyst (added)* and City Council should have the authority to make requests of the Audit Committee and Auditor General to perform internal audits of material matters they reasonably believe to be warranted. (Page 252) No change.
23. With the assistance of the CFO and Auditor General, the City's independent auditors would be retained by, report to and take direction from the Mayor and City Council. The Audit Committee will provide input on an advisory basis. (Page 252)
24. The Audit Committee, in an advisory capacity to the Mayor and City Council, should have responsibility for the establishment and monitoring of effective policies and procedures for dealing with "whistleblower" complaints, including an internal hotline. (Pages 252 & M-6)

Remedial Category – Ethics

42. To discourage any improper influence of the professionals who serve as "gatekeepers" to the public financial reporting process of the City, the Municipal Code should be amended to add criminal penalties for such conduct. It should be unlawful for any elected official, or employee of the City, or anyone acting under their direction, to take any action to corruptly influence, coerce, manipulate or mislead any independent certified public accountant engaged in the performance of an audit of the financial statements of the City or its component units, or outside legal counsel performing services for the City in connection with an offering statement of the City, or any actuary performing an actuarial valuation in connection with the preparation of the City's or SDCERS's CAFRs, or employees of a bond rating agency performing a credit rating of the City's bonds. (Page M-6)

Status: Waiting promised Ordinance from City Attorney's office.

Remedial Category – Budget Policies and Practices

43. In order to maintain current service levels and address issues such as deferred maintenance, the City must reduce expenditures by improving efficiency, increasing the current revenue base, and seeking alternative revenue sources. (Page M-14)

Status: As the City develops its first five-year financial plan, it will address current service levels and other budgetary demands.

II. Remedial Items In-Process

44. Ongoing expenditures should be supported by ongoing revenues; capital projects should identify all future cost considerations and financial impacts, including direct and indirect costs for each Enterprise Fund; activities supported by user fees should be fully cost recoverable; discretionary General Fund revenues should not be earmarked; increase the General Fund reserve to the range of 7-10%; budget development should be guided by a long term or strategic plan proposed by the Mayor and adopted by the City Council; and after adoption, annual budgets should be amended only for urgent needs. Specific funding sources should be identified to pay for these needs. (Pages M-14 & M-15)

Status: A General Fund reserve policy will be presented to the Budget and Finance Committee at its November 29th Committee meeting and to the full Council for action at a subsequent meeting in December. The policy will identify a reserve account, separate from the "deep" reserves, which will serve as a contingency for unanticipated expenses approved by City Council during a given fiscal year.

Remedial Category – Retirement Benefits

87. The City Council and employees should develop realistic retirement plan parameters for future City hires. This includes positioning the City to attract and retain the talent needed to meet the citizens' expectations for services, not be viewed as providing excessive benefit levels, and creating a plan the City can afford. (Page M-25)

Status: A benchmark study of health and retirement benefits for all employees is in process. Additionally, benchmark studies of police and fire compensation are in process.



OFFICE OF MAYOR JERRY SANDERS
CITY OF SAN DIEGO

MEMORANDUM

Date: October 5, 2006

To: Honorable Members of the City Council

From: Mayor Jerry Sanders *[Signature]* for Jerry Sanders

Subject: Kroll Remediation Status for October 16, 2006, Council Meeting

In my memorandum dated August 24, 2006, I reported my staff had identified 121 items for remediation from the Kroll Report. These items were grouped by remedial category and were described in detail along with anticipated due dates. On October 16, 2006, my staff will meet with you to discuss the following:

- Status of remedial items identified for completion in September 2006 (items 1-6, 46-47, 48.ii, 84-86)
- Status of the implementation of the organizational structure for financial operations (addresses items 7-14)
- Additional remedial items identified (items 4.1, 20.1, 52.1, 52.2, 57.1, 107.1, 118.1, 120.1)

The numbering convention for the additional remedial items follows the remedial categories identified in my August 24, 2006, memorandum. For example, "new" item 4.1 matches the remedial category of Oversight Monitor and is most closely associated with item 4 from my prior memorandum.

Attachment A – Financial Operations Organizational Charts

Cc: City Attorney
BA
Chief Operating Officer
Chief Financial Officer
SDCERS
John Dyer

A. Completed Items**Remedial Category – City Actuarial Services**

46. The City should periodically, but no less frequently than every three years, retain its own actuary to review the SDCERS actuarial valuation and the assumptions used, and to provide an independent assessment of the valuation and its implications for the City. (Pages 260, M-11 & M-12)
47. The City must retain its own actuary responsible for determining for the City the cost of each proposed new retirement benefit and to issue a report thereon to the City Council before an ordinance is adopted conferring the benefit. (Pages 260 & M-12)

Status: Complete. The City has retained an actuary, Joseph Esuchanko. The City's actuary is nearly complete with his first report. The delay in his completion is the result of additional work assigned by the City in order to assist with the calculation of the City's Net Pension Obligation for the 2003 CAFR. Revised due date for the report is November 2006.

Remedial Category – Deferred Maintenance

48. We recommend that the Mayor and the Budget Director establish a process to identify and prioritize deferred maintenance and unfunded procurement needs. The Budget Director should prepare and present a public report identifying cumulative deferred maintenance and unfunded procurement needs during the annual budget hearings. The City's approach to funding deferred maintenance and unfunded procurement should be changed to allow for increased funding in these areas. (Page M-21)

In responding to this item, the Mayor's August 24, 2006, memorandum identifies four specific components (i, ii, iii and iv). Only items i and ii are addressed below.

- i. (48.i) Development of a Facility Category Index to identify facilities and assets critical to the mission of the City and prioritize those assets for funding to address deferred maintenance requirements.

Status: Complete. The due date indicated in my August 24, 2006, memorandum for this item should have been September 2006 instead of September 2007. This date was transposed with item 48.ii.

- ii (48.ii) Development of an asset inventory to create current inventories of essential infrastructure assets (e.g., Chiller Plants, Boilers, Pumps, High Voltage Switch Gear).

Status: Not complete. The due date for this item was misstated as September 2006. The correct due date is September 2007.

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B. In Process Items

Remedial Category - Oversight Monitor

1. Appoint a Monitor to oversee the implementation of and compliance with the Remediation Plan. (Pages 263 & M-14)
2. The Monitor should be selected by the Mayor in consultation with the City Council and subject to the approval of the SEC and should be an independent person of suitable standing, independence and experience for the assignment. (Pages 263 & M-14)
3. The Monitor should have complete and unfettered access to all City and SDCERS personnel and records. (Pages 263 & M-14)
4. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)
5. The Monitor should serve a term of no less than three years and should be provided adequate resources to carry the duties of his office. (Pages 263 & M-14)
6. The SEC should have the right, upon request, to expand the scope of the Monitor's duties following consultation with the City. (Pages 263 & M-14)

Status: In process. The appointment of an SEC approved Monitor is a recommendation that the Mayor supports. Further discussion with Council and the City Attorney's Office is needed to determine the term of retention and scope of duties. That discussion will occur prior to the November 13th, 2006, Council date, where a detailed presentation will be made.

Remedial Category - Reconciliation of Accounts

84. The City must develop an improved cash reconciliation process, which is more automated, documented, and complete. The revised process must support accuracy, timely completion, and improved ease of review. (Page M-16)
85. The City should develop and implement a timely and less cumbersome bank reconciliation process to clearly reconcile bank and the general ledger balances. The improved process should facilitate timely completion, ease of review, correction of errors, and enhance communication between the Comptroller's and Treasurer's staff. (Page M-16)

Status: In process. Cash for fiscal years 2003 and 2004 have been reconciled and reported to the City's external auditors. The establishment of a formal documented process will be complete by November 2006.

86. City Departments should reconcile all accounts receivable and deferred revenue accounts to supporting information at period ends. Supervisors should review these reconciliations for completeness and accuracy. (Page M-23)

Status: In process. This is a significant task requiring reconciliations by each City department with material revenue. The process documentation for reconciling accounts receivable and deferred revenue to supporting information for each period needs to be updated. Subsequently, appropriate City employees require training on the process. Finally, the processes (by department) need to be tested to confirm operating effectiveness. Revised completion date is June 2007.

II – Status of the Implementation of the Organizational Structure for
Financial Operations

002011

Remedial Category – Organizational Structure

7. Centralize accountability for the accuracy and credibility of the City's financial reporting under the CFO. The areas of responsibility would include, a City Comptroller, a Director of Financial Reporting, the Financial Management Director, Director of Debt Management and City Treasurer. (Pages 245 & M-1)

Status: Completed. Prior to January 2006, the City's financial reporting structures were distributed throughout the organization. Some reported up to the City Manager through a Deputy and Assistant City Manager while the City Auditor & Comptroller, a separate department, reported to the Mayor and Council. This structure did not promote coordination, communications, accountability or transparency. One of the first changes I made upon taking office was to create the position of Chief Financial Officer (CFO) who is responsible for what I am calling the Department of Finance. The CFO is ultimately accountable for the accuracy and credibility of the City's financial reporting.

See organizational chart in Attachment A, 2006 Department of Finance. The City Comptroller (Auditor & Comptroller), Director of Financial Reporting (Financial Management), Director of Debt Management (Debt Management), and City Treasurer (Treasury) report directly to the CFO.

8. The Director of Planning, Budgeting and Financial Analysis (Financial Management Director) should report directly to the CFO and have principal responsibility for preparing an annual budget, a monthly budget with comparisons of budget to actual results year-to-date, analyses of variances and a quarterly report to the City Council and public setting forth budget versus actual results. (Pages 246 & M-2)

Status: Completed. The Financial Management Director reports directly to the CFO and has primary responsibility for preparing the annual budget. Quarterly reports have been provided to the City Council and public.

9. The City Treasurer should report to the CFO and have principal responsibility for all treasury functions for the City. (Pages 246 & M-2)

10. The CFO should have primary responsibility for, and have as direct reports, personnel with functional authority over accounting and financial analysis, treasury, planning and budgeting and financial reporting. This should include authority over those responsible for all information systems required by these functions. (Page M-1)

11. The Budget Director should report directly to the CFO and have principal responsibility for preparing an annual budget, a monthly budget with comparisons of budget to actual results year-to-date, analyses of variances, and a quarterly report to the City Council and public setting forth budgeted versus actual results. The Budget Director's Office should serve as a resource for financial analysis, planning assistance, and services to other City departments and agencies. (Page M-2)

002012

II – Status of the Implementation of the Organizational Structure for Financial Operations

12. The City Treasurer should report to the CFO and have principal responsibility for all treasury functions for the City. The Office of the Treasurer and the duties assigned to that Office shall be as otherwise described in the City Charter. (Page M-2)

Status: Completed. The City Treasurer and the Budget Director report directly to the CFO. The CFO has authority over accounting and financial analysis, treasury, fiscal planning, budgeting and financial reporting and the systems that support these responsibilities. See organizational charts in Attachment A.

13. Establish the position of City Comptroller responsible for accounting and financial reporting, including preparation of the CAFRs and reporting to the CFO. (Pages 245, 246 & M-2)

14. Establish the position of Director of Financial Reporting responsible for the preparation of the City's periodic financial statements. (Pages 246 & M-2)

Status: The establishment of a Comptroller position will require a City Charter change. Anticipated ballot date is June 2008. Currently, the duties outlined for the Director of Financial Reporting are the shared responsibility of the Auditor & Comptroller and the Financial Management Director. More distinct delineation of duties will be established once the Director of Financial Reporting position has been created.

002013

Since the delivery of my August 24, 2006, memorandum on "Responses to the Remedial Recommendations Found in the Kroll Report," staff has combed through the Kroll Report an additional time and has identified a number of additional recommendations. Most of these closely tie to remedial recommendations already identified and often provide some additional clarity. These additional items are discussed below. As discussed in my cover memorandum to this document, any number listed below that is a whole number (i.e., 4, 20, 52, etc.) reflect remedial recommendations previously identified. The other numbers that follow (i.e., 4.1, 20.1, 52.1, 52.2, etc.) represent newly reported items.

Remedial Category – Oversight Monitor

4. Original Item. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)

- 4.1. Additional Item. City Monitor quarterly reports should be made public in an appropriate manner including on the City's website. (Page M-14)

Response: After the City appoints a Monitor and receives quarterly reports on the progress of implementation, these reports will be made public on the City's website.

Remedial Category – Audit Committee; Formation and Duties

20. Original Item. The Audit Committee should establish a written charter. (Pages 251 & M-6)

- 20.1. Additional item. The City's Audit Committee should approve the annual compensation of the Auditor General and the annual budget for the Auditor General's staff. (Page M-5)

Response: Requires City Charter Change. Due date is June 2008.

Remedial Category – Disclosure

- 52 Original Item. The City Council should have at least two weeks to review substantially completed drafts of a preliminary offering statement before it is asked to vote to approve the final document. (Pages 263 & M-14)

- 52.1. Additional Item. The City Council members should also establish a reasonable period of time for the review of a final offering statement document, with marked changes from earlier drafts. (Page M-14)

- 52.2 Additional Item. The City CAFR is an integral component of the financial information provided as part of any debt issuance; the City Council should review and approve its use following the same procedures as offering statements. (Page M-14)

III – Additional Remedial Items Identified

Response: City Council should establish a reasonable period of time by December 31, 2006.

Remedial Category – Financial Reporting

57 **Original Item.** At year-end, a budget should be presented to the City Council containing a final budget-to-actual comparison, along with an explanation of variances by department. (Pages 262 & M-13)

57.1 **Additional Item.** Inter-departmental transfers to meet budget goals, or for any other purpose, should not be permitted unless approved in advance by the City Council. (Page M-13)

Response: It is staff's position that this has been implemented. First, the Appropriation Ordinance has been modified to remove the kind of flexibility to move funds around that were given the City Manager and Auditor and Comptroller in prior fiscal years. In addition, the City Council, through the Business Process Re-engineering (BPR) Ordinance still has the authority to review and take action on any and all movement of funds which result from BPRs prior to staff's processing any transfers. The City Council will be asked to approve the ultimate movement of funds via an amendment to the Appropriation Ordinance periodically throughout the fiscal year.

Remedial Category – City Funding of SDCERS

107 **Original Item.** The City and SDCERS should make a voluntary disclosure through a self-reporting process to the IRS of the amount of any improper diversion of funds used to pay retiree health care benefits and cooperate with the IRS to bring the City's retiree healthcare funding into full compliance. (Pages 259 & M-11)

107.1 **Additional Item.** Make early disclosure of such costs (retiree healthcare benefits) in its next issued financial statement. (Page M-11)

Response: While the City has not published the Net OPEB Obligation on its balance sheet, it has disclosed its actuarially developed liability in the transmittal letter of the fiscal year 2003 CAFR. It will do the same in all subsequent CAFRs and will begin reporting its Net OPEB Obligation in fiscal year 2008.

Remedial Category – SDCERS Board Structure

118 **Original Item.** Prior to any appointment, each potential appointee be required to complete a written application listing qualifications for the position and any factors that may impact on that decision, and that the applicants be required to affirm the accuracy of the application and a background check of the applicants should be done by the appropriate City department. (Pages 256 & M-9)

118.1 Additional Item. SDCERS board applications should be shared with the Business and Governance Committee of the SDCERS board. (Page M-9)

Response: City staff will work with SDCERS.

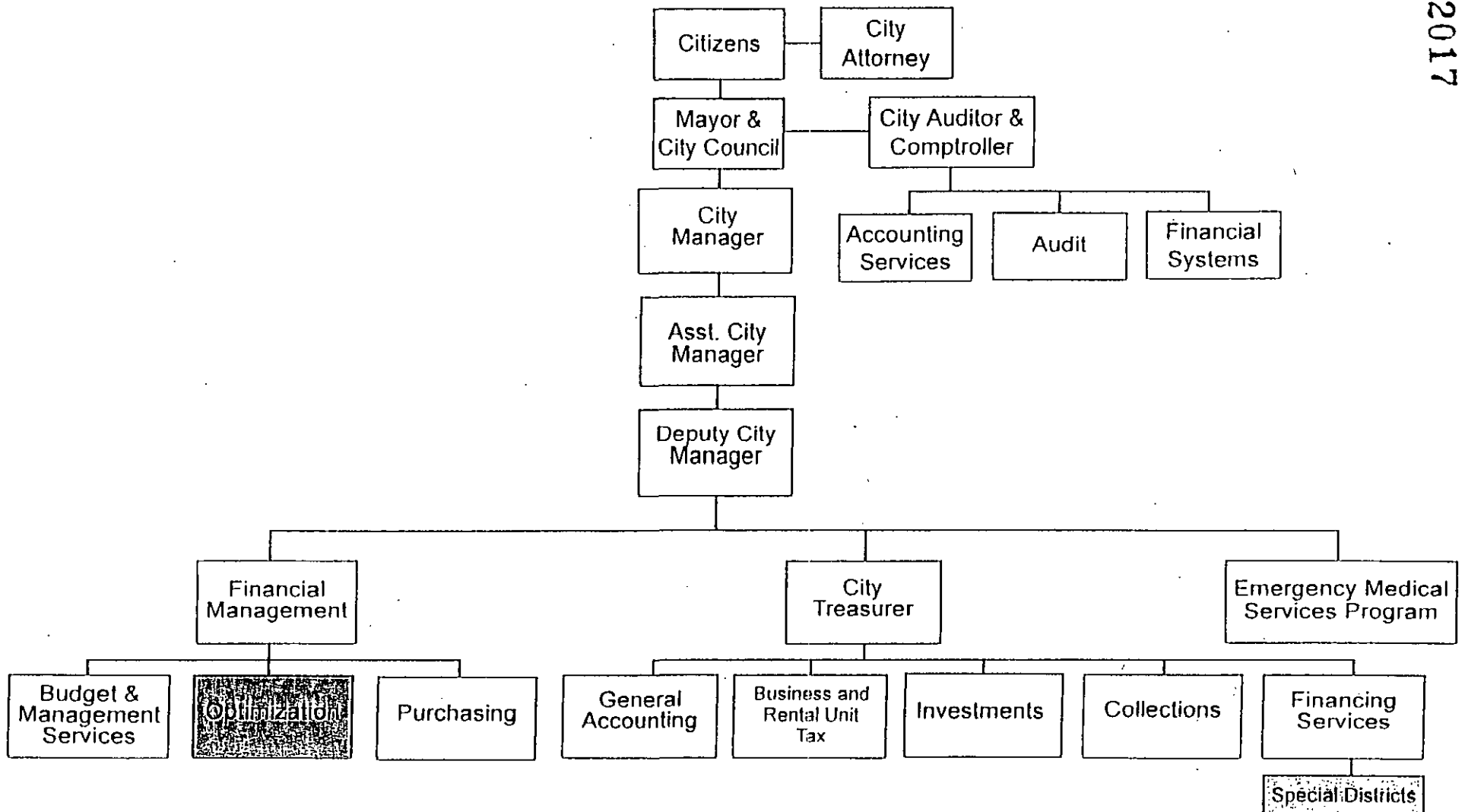
120 Original Item. SDCERS should adopt a formal charter for each committee which should be updated no less frequent than every three years. Pages 257 & M-9)

120.1 Additional Item. The annual SDCERS CAFR should include a report from each of its standing committees on significant activities during the year. (Page M-9)

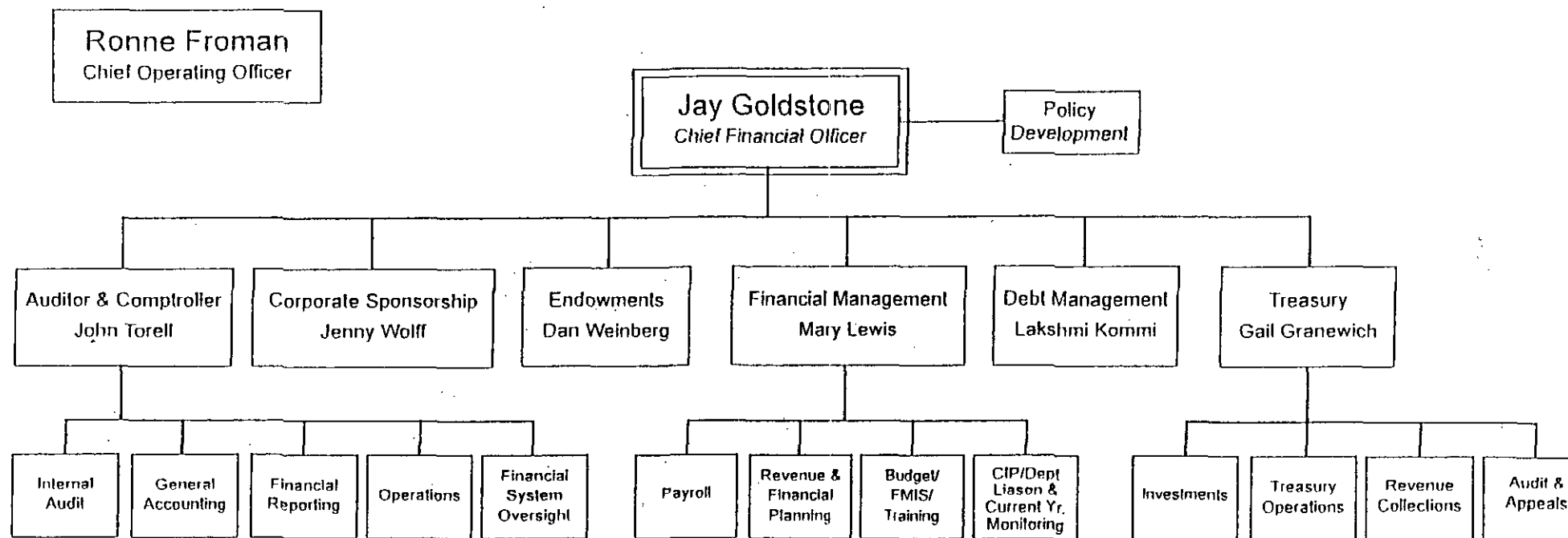
Response: Staff will work with SDCERS staff.

FINANCIAL MANAGEMENT 2005

002017

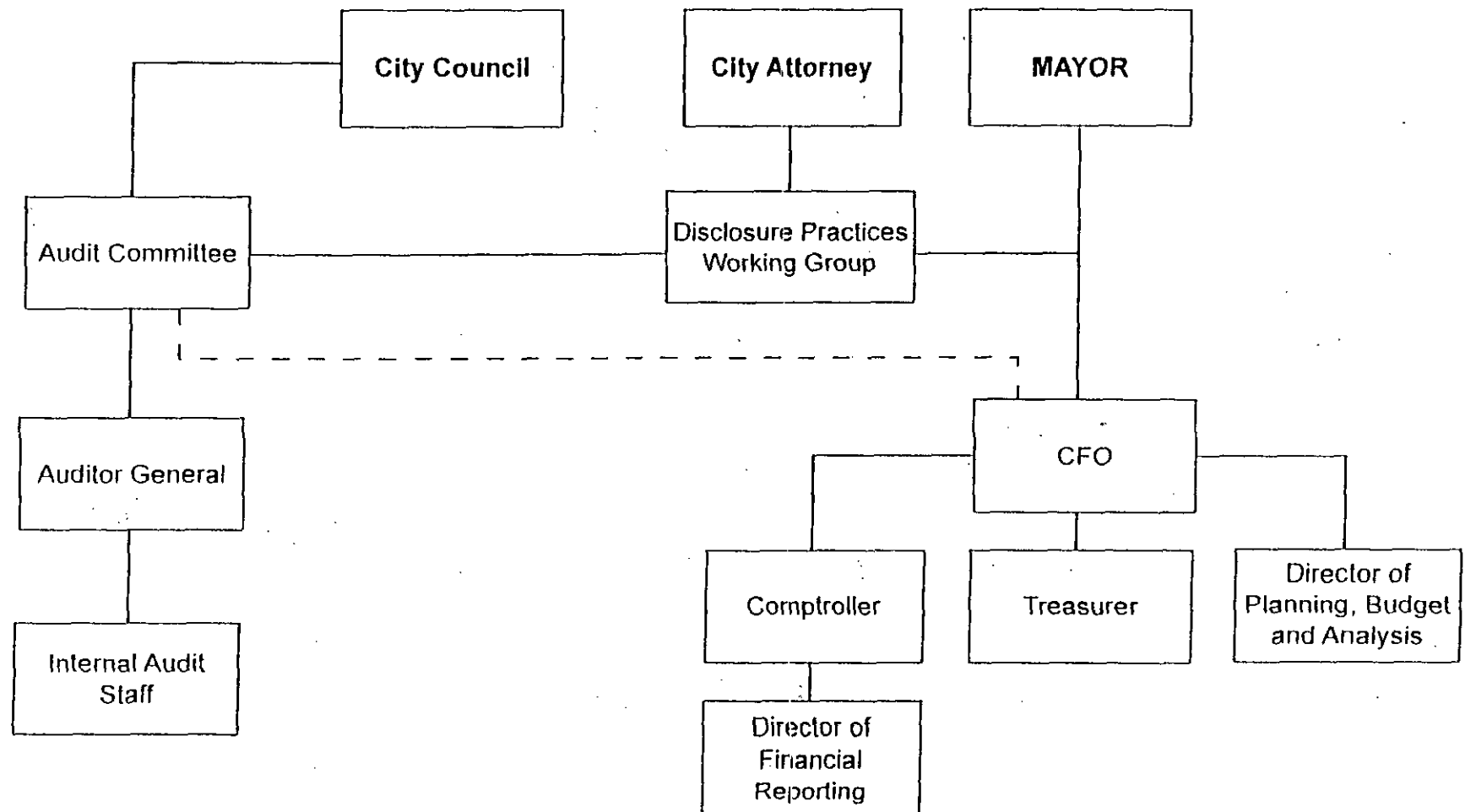


2006 DEPARTMENT OF FINANCE



APPENDIX N OF THE KROLL REPORT PROPOSED FINANCIAL REPORTING REORGANIZATION

002019



NOTE: Support to the Audit Committee would be provided by the CFO and Auditor General and their Staffs.

002021



**OFFICE OF MAYOR JERRY SANDERS
CITY OF SAN DIEGO**

MEMORANDUM

Date: November 22, 2006
To: Honorable Members of the City Council
From: Mayor Jerry Sanders
Subject: Kroll Remediation Status Report Number 3, prepared for
December 6, 2006, Council Meeting

In my memorandum dated August 24, 2006, I reported my staff had identified 121 items for remediation from the Kroll Report. These items were grouped by remedial category and were described in detail along with anticipated due dates. I have already issued two memorandums on status (dated October 5, 2006, and October 30, 2006). This is my third memorandum regarding status of the City's Kroll remediation efforts. On December 6, 2006, my staff will meet with you to discuss the following:

- Status of remedial items completed as of December 6, 2006
- Status of remedial items in-process as of December 6, 2006

Cc: City Attorney
Chief Operating Officer
Chief Financial Officer
Independent Budget Analyst
SDCERS
John Dyer

I. Remedial Items Completed

A. Items Previously Reported Complete

Kroll Item #	Kroll Category	Memorandum Reference
7-12	Organizational Structure	October 5, 2006
24	Audit Committee – Formation and Duties	October 30, 2006
45	Budget Policies and Practices	October 30, 2006
46-47	City Actuarial Services	October 5, 2006
48(i)	Deferred Maintenance	October 5, 2006
54-57	Financial Reporting	October 30, 2006
57.1	Financial Reporting	October 5, 2006
74	Interest Allocation	October 30, 2006
84-85	Reconciliation of Accounts	October 30, 2006
107.1	City Funding of SDCERS	October 5, 2006

B. Items Completed During this Reporting Period

Remedial Category – Disclosure

49. Continue the operations of the Disclosure Practices Working Group (DPWG) and add the CFO not only as an official member but also have this person serve as chair. (Pages 249, M-4 & M-5)

Status: Mayoral task complete. The Mayor's Office submitted a Request for Council Action that the City Council direct the City Attorney to amend the Municipal Code¹ for the following changes to the DPWG.

- The Chief Financial Officer will serve as the chair of the revised DPWG.
- Membership in the DPWG will consists of the following five official voting members: Chief Operating Officer, Chief Financial Officer, City Attorney, Auditor General and Independent Budget Analyst (or designees). Outside disclosure counsel serves as an ex-officio member.
- No DPWG committee member (including the Chair) can prevent any other committee member from placing an item on the agenda.

Remedial Category – Forecasting/Projections

66. The CFO and Mayor should submit annually to the City Council as part of the annual budgeting process, a rolling five-year proposed plan that contains major items, including capital expenditures, deferred maintenance, debt payments and

¹ San Diego Municipal Code, Chapter 2: Government, Article 2, Administrative Code, Division 41: Securities Disclosure

002024

other major contractual obligations, major revenues by category and a forecast of gross cash receipts and gross cash expenditures. (Pages 262 & M-13)

Status: Complete. The Mayor announced the City's first five-year financial plan on November 14, 2006. The plan will be presented to the City Council on November 29, 2006. The plan addresses major items, including capital expenditures, deferred maintenance, debt payments and other major contractual obligations, major revenues by category and a forecast of gross cash receipts and gross cash expenditures. The plan can be accessed on the City's website at:

http://www.sandiego.gov/mayor/pdf/five_year_plan_11_15.pdf

Remedial Category – City Funding of SDCERS

107. The City and SDCERS should make a voluntary disclosure through a self-reporting process to the IRS of the amount of any improper diversion of funds used to pay retiree health care benefits and cooperate with the IRS to bring the City's retiree healthcare funding into full compliance. (Pages 259 & M-11)

Status: Complete. SDCERS tax consultant, Ice Miller LLP, filed a Voluntary Correction Plan report titled "Exclusive Benefit and Prohibited Transactions – Retiree Medical Benefits (401(h) Account)" with the Internal Revenue Service on June 22, 2006.

108. The costs should be reflected in the City's annual budget and five-year plan, and variances caused by changes in actuarial assumptions should be explained. (Page 260)

Status: Complete. For clarification purposes, Kroll item 108 relates to costs for proposed new retirement benefits for city employees.

The City acknowledges the need to accurately calculate the costs of any new retirement benefits and includes such costs in all budgets and five-year plans. Additionally, the voters passed Proposition B which will require the City to obtain voter approval for any increases (with the exception of cost-of-living) in municipal pension benefits.

II. Remedial Items In-Process

A. Items In-Process Previously Reported

Kroll Item #	Kroll Category	Memorandum Reference	Updated status?
1-6	Oversight Monitor	October 5 and 30, 2006	Yes *
13-14	Organizational Structure	October 5, 2006	No
18-23	Audit Committee, Formation and Duties	October 30, 2006	No
42	Ethics	October 30, 2006	Yes *
43-44	Budget Policies and Practices	October 30, 2006	No
86	Reconciliation of Accounts	October 5, 2006	No
87	Retirement Benefits	October 30, 2006	Yes *

* see below

Remedial Category - Oversight Monitor

1. Appoint a Monitor to oversee the implementation of and compliance with the Remediation Plan. (Pages 263 & M-14)
2. The Monitor should be selected by the Mayor in consultation with the City Council and subject to the approval of the SEC and should be an independent person of suitable standing, independence and experience for the assignment. (Pages 263 & M-14)
3. The Monitor should have complete and unfettered access to all City and SDCERS personnel and records. (Pages 263 & M-14)
4. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)
 - 4.1 City Monitor quarterly reports should be made public in an appropriate manner including on the City's website. (Page M-14)
5. The Monitor should serve a term of no less than three years and should be provided adequate resources to carry the duties of his office. (Pages 263 & M-14)
6. The SEC should have the right, upon request, to expand the scope of the Monitor's duties following consultation with the City. (Pages 263 & M-14)

Updated Status: In process. The Kroll Report recommended an independent monitor oversee implementation of and compliance with the Remediation Plan. The City's settlement with the Security and Exchange Commission (SEC) requires that an independent consultant/monitor be hired within 60 days from the November 14, 2006, settlement date. The City believes that the independent consultant function called for by the SEC and the monitor role recommended in the Kroll Report can be reconciled and performed by the same person.

Remedial Category – Ethics

42. To discourage any improper influence of the professionals who serve as "gatekeepers" to the public financial reporting process of the City, the Municipal Code should be amended to add criminal penalties for such conduct. It should be unlawful for any elected official, or employee of the City, or anyone acting under their direction, to take any action to corruptly influence, coerce, manipulate or mislead any independent certified public accountant engaged in the performance of an audit of the financial statements of the City or its component units, or outside legal counsel performing services for the City in connection with an offering statement of the City, or any actuary performing an actuarial valuation in connection with the preparation of the City's or SDCERS's CAFRs, or employees of a bond rating agency performing a credit rating of the City's bonds. (Page M-6)

Updated Status: City Attorney action complete. The City Attorney prepared an ordinance and submitted it for City Council Action on November 1, 2006. On November 13, 2006, at the Special City Council Financial Hearing, the ordinance was referred to the Rules Committee. The Rules Committee is tentatively scheduled to review the ordinance at its scheduled meeting on January 10, 2007.

Remedial Category – Retirement Benefits

87. The City Council and employees should develop realistic retirement plan parameters for future City hires. This includes positioning the City to attract and retain the talent needed to meet the citizens' expectations for services, not be viewed as providing excessive benefit levels, and creating a plan the City can afford. (Page M-25)

Updated Status: The following three evaluations are in process and should be complete by December 29, 2006:

- Actuarial evaluations of the cost implications of formula changes to the existing retirement systems
- Benchmark study of Police Compensation and benefits for all employees
- Benchmark study of Fire Compensation and benefits for all employees

II. Remedial Items In-Process

002027

B. Items In-Process During this Reporting Period

There are over 120 Kroll remediation items that span many categories, departments and related entities. My staff continues to coordinate with the responsible parties related to Kroll remediation status and milestone dates.

Additionally, for Kroll remediation items that can be executed by accounting/finance staff, Jay Goldstone, Chief Financial Officer, has established a dedicated team which has kicked-off remediation planning, scoping and action for the following Kroll items.

Kroll Item #	Kroll Category
58-59, 64-65	Financial Reporting
75-80 *	Internal Controls
81	Personnel
82	Procurement
83	Redevelopment Authority
86	Reconciliation of Accounts
88-89	Risk Management
90,95	Training

* Kroll item 76 will require significant effort because it addresses remediation of internal control weaknesses identified in the Auditor and Comptroller's 2006 Annual Report on Internal Controls as well as Management Letters from the City's external auditors. As of November 22, 2006, my staff has identified approximately 35 additional financial internal control items that require remediation by June 30, 2007.

002029

REQUEST FOR COUNCIL ACTION
CITY OF SAN DIEGO

(FOR AUDITOR'S USE ONLY)


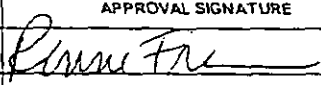
TO: Council President	2. FROM (ORIGINATING DEPARTMENT): Mayor Sanders	3. DATE: November 22, 2006
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4. SUBJECT: Remediation Status Report Number 3 and Related Action		
5. PRIMARY CONTACT (NAME, PHONE & MAIL STA.): Jay Goldstone / 236-5941	6. SECONDARY CONTACT (NAME, PHONE & MAIL STA.): John Dyer / 533-3978	7. CHECK BOX IF REPORT TO COUNCIL IS ATTACHED <input type="checkbox"/>

8. COMPLETE FOR ACCOUNTING PURPOSES

FUND					9. ADDITIONAL INFORMATION / ESTIMATED COST:
DEPT.					
ORGANIZATION					
OBJECT ACCOUNT					
JOB ORDER					
C.I.P. NUMBER					
AMOUNT					

10. ROUTING AND APPROVALS

ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED	ROUTE (#)	APPROVING AUTHORITY	APPROVAL SIGNATURE	DATE SIGNED
1	ORIGINATING DEPARTMENT		11/22/06	8	COO		11/22/06
2				9			
3				10			
4				11			
5				DOCKET COORD: _____ COUNCIL LIAISON: _____ <input checked="" type="checkbox"/> COUNCIL PRESIDENT <input type="checkbox"/> SPOB <input type="checkbox"/> CONSENT <input type="checkbox"/> ADOPTION <input type="checkbox"/> REFER TO: _____ COUNCIL DATE: _____			
6							

 11. ACTION OF: ☒ RESOLUTION(S) ☒ ORDINANCE(S) ☐ AGREEMENT(S) ☐ DEED(S)

Please docket the following for discussion at the special December 6, 2006 City Council meeting:

1. third informational update report on the Kroll remediation, and
2. directing the City Attorney to prepare an Ordinance amending the Municipal Code¹ consistent with the following changes:

- The Chief Financial Officer will serve as the chair of the revised DPWG.
- Membership in the DPWG will consists of the following five official voting members: Chief Operating Officer, Chief Financial Officer, City Attorney, Auditor General and Independent Budget Analyst (or designees). Outside disclosure counsel serves as an ex-officio member.
- No DPWG committee member (including the Chair) can prevent any other committee member from placing an item on the agenda.

11A. STAFF RECOMMENDATIONS:

1. Docket the requested items for discussion
2. Approve the recommended action

12. SPECIAL CONDITIONS:

COUNCIL DISTRICT(S): ALL

COMMUNITY AREA(S):

ENVIRONMENTAL IMPACT:

HOUSING IMPACT:

OTHER ISSUES:

¹ San Diego Municipal Code, Chapter 2: Government, Article 2, Administrative Code, Division 41: Securities Disclosure

002031



**OFFICE OF MAYOR JERRY SANDERS
CITY OF SAN DIEGO**

MEMORANDUM

Date: February 21, 2007

To: Honorable Members of the City Council

From: Mayor Jerry Sanders *JSL*

Subject: Kroll Remediation Status Report Number 4, prepared for March 5, 2007 Council Meeting

This is the Fourth in a series of status reports regarding Kroll Remediation efforts. To date, approximately 53 or 44% of the 121 Kroll remediation items have been completed, or are substantially complete and more than 25 additional items are in-process. Previous status reports were issued on October 5, 2006, October 30, 2006 and November 22, 2006. On March 5, 2007 my staff will meet with you to discuss the following:

- Status of remedial items completed as of February 16, 2007
- Status of remedial items in-process as of February 16, 2007
- Revisions to the Disclosure Practices Working Group

The status of all Kroll remediation items will be provided to Mr. Stanley Keller, Independent Monitor, for observations and comments. Any conclusions made by him will be provided to the City Council for its review.

Cc: City Attorney
Chief Operating Officer
Chief Financial Officer
Stanley Keller, Independent Monitor
Independent Budget Analyst
SDCERS
John Dyer

Attachment A - CFO Resume

Attachment B - City Attorney Report Regarding Remediation Measures Requiring Changes to the City Charter, and Related Matters

Attachment C - Establishment of a Charter Review Committee

Attachment D - Disclosure Practices Working Group Controls and Procedures

Attachment E - Status of Kroll Remediation Items Involving SDCERS

A. Items Previously Reported Complete

Kroll Item #	Kroll Category	Memo Reference	Additional Action Required		
			City Attorney	City Council	Mayor
7-12	Organizational Structure	10/5/2006			
24	Audit Committee – Formation and Duties (whistleblower procedures)	10/30/2006		Note A	
45	Budget Policies and Practices	10/30/2006			
46-47	City Actuarial Services	10/5/2006			
48(i)	Deferred Maintenance	10/5/2006			
49	Disclosure (DPWG)	11/22/2006		Note B	
54-57	Financial Reporting	10/30/2006			
57.1	Financial Reporting	10/5/2006			
66	Forecasting/Projections	11/22/2006			
74	Interest Allocation	10/30/2006			Note C
84-85	Reconciliation of Accounts	10/30/2006			Note C
107-108	City Funding of SDCERS	11/22/2006			
107.1	City Funding of SDCERS	10/5/2006			

Notes:

-
- A. Audit Committee to assume selected areas of responsibility for "whistleblower" policies and procedures
- B. City Council action required to direct the City Attorney to modify the Municipal Code to change the membership of the Disclosure Practices Working Group (DPWG)
- C. Internal control operating design is complete; operating effectiveness (testing) to be performed
-

I. Remedial Items Completed

B. Items Completed During this Reporting Period

Kroll Item #	Kroll Category	Memo Reference	Additional Action Required		
			City Attorney	City Council	Mayor
1-6	Oversight Monitor	2/16/2007			
15	Staff Qualifications	2/16/2007			
18	Audit Committee – Formation and Duties (Long-Term Plan)	2/16/2007			Note D
19	Audit Committee – Formation and Duties (Eliminate FROB)	2/16/2007	Note E		
21	Audit Committee – Formation and Duties (Scheduled Meetings)	2/16/2007			
42	Ethics	2/16/2007		Note F	
43	Budget Policies and Practices	2/16/2007		Note G	
51	Disclosure (City Attorney Confirmation)	2/16/2007			Note H
52	Disclosure (City Council Review Period)	2/16/2007			
53	Disclosure (DPWG and Audit Committee)	2/16/2007		Note I	
71	Information Technology – Financial Reporting Systems	2/16/2007			Note J
73	Information Technology – E-Mail Systems	2/16/2007			Note K
82	Procurement	2/16/2007			Note H
89	Risk Management	2/16/2007			
96	Training	2/16/2007		Note L	
97	SDCERS Financial Reporting	2/16/2007			
98	SDCERS Internal Controls	2/16/2007			
99	SDCERS Actuarial Services	2/16/2007			
100-101	SDCERS Investment Advisors	2/16/2007			
103	City Funding of SDCERS	2/16/2007			
106	City Funding of SDCERS	2/16/2007		Note M	
113	SDCERS Organizational Structure	2/16/2007			
114	SDCERS Staff Qualifications	2/16/2007			
119,121	SDCERS Board Structure	2/16/2007			

I. Remedial Items Completed

Notes:

- D. Establishment of a Charter Review Committee; part of the committee's responsibilities include the long-term Audit Committee plan
- E. City Attorney to eliminate Financial Reporting Oversight Board (FROB) as redundant to the new Audit Committee
- F. Improper influence Ordinance is with Rules Committee for action
- G. City Council to review budget in April 2007
- H. Internal control operating design is complete; operating effectiveness (testing) to be performed
- I. Continued by City Council
- J. Short-term plan complete; long-term plan to be completed as part of ERP project
- K. Short-term plan complete; long-term plan scheduled for completion by September 2007
- L. Financial training budget to be submitted to City Council as part of midyear budget adjustment
- M. The repeal of "Waterfall" is in the process of being docketed with City Council

Remedial Category -- Oversight Monitor

1. Appoint a Monitor to oversee the implementation of and compliance with the Remediation Plan. (Pages 263 & M-14)
 2. The Monitor should be selected by the Mayor in consultation with the City Council and subject to the approval of the SEC and should be an independent person of suitable standing, independence and experience for the assignment. (Pages 263 & M-14)
-
3. The Monitor should have complete and unfettered access to all City and SDCERS personnel and records. (Pages 263 & M-14)
 4. The Monitor should make quarterly reports to the City and the SEC on the City's progress. (Pages 263 & M-14)
 - 4.1 City Monitor quarterly reports should be made public in an appropriate manner including on the City's website. (Page M-14)
 5. The Monitor should serve a term of no less than three years and should be provided adequate resources to carry out the duties of his office. (Pages 263 & M-14)
 6. The SEC should have the right, upon request, to expand the scope of the Monitor's duties following consultation with the City. (Pages 263 & M-14)

Status: Complete. On January 16, 2007, the City Council approved a recommendation to hire Mr. Stanley Keller to provide the City with independent monitoring services called out in the Security and Exchange Commission's (SEC) order as well as in the Kroll report. In performing his work, the Monitor will have complete access to all City and SDCERS personnel and records. The Monitor was hired for a three year term and his

I. Remedial Items Completed

002035

agreement with the City calls for annual reports to the City and the SEC. The First report is due 120 days following the approval of the agreement by the City Council.

The announcement of the City's hiring of Mr. Keller for independent Monitoring services is on the City's website at the following address:

http://www.sandiego.gov/mavor/pdf/keller_statement_1_16.pdf

Remedial Category – Staff Qualifications

15. The CFO should have significant experience with governmental operations, including accounting, financial reporting and applicable disclosure standards, rules and regulations. The CFO should in particular have experience in the preparation of a CAFR in accordance with governmental accounting standards and offering statements for a municipal issuer. (Pages M-1 to M-2)

Status: Complete. The City hired its first-ever CFO, Mr. Jay Goldstone, who started on January 23, 2006. Mr. Goldstone has significant experience with government operations, including accounting, financial reporting and applicable disclosure standards, rules and regulations. See Attachment A for Mr. Goldstone's resume.

Remedial Category – Audit Committee Formation and Duties

18. The City should establish a three member Audit Committee comprised of two members from the public and one City Council Member. The public members would be nominated by the Mayor and confirmed by the City Council. (Pages 251 & M-6)

Status: Short-term action complete. My memorandum to the City Council dated October 31, 2006 had a long-term and short-term plan for the Audit Committee. A long-term plan is required because a City Charter change is necessary to fully meet the Audit Committee recommendations identified in item 18 above. Refer to Attachment B for the City Attorney's letter dated September 1, 2006, regarding Kroll Audit Committee conflicts with the City Charter. The City recently established a Charter Review Committee (refer to Attachment C). One of the areas the committee will focus on is "What Charter modifications are necessary to implement the Kroll recommendations and other financial reforms?"

On December 6, 2006 the City Council directed the City Attorney to prepare an ordinance to amend the Municipal Code to form an interim audit committee. The City Council approved the establishment of a temporary Audit Committee on January 9, 2007 (Council item 332b). Additionally, the Council confirmed the appointments of three Council members to the temporary audit committee (item 333).

I. Remedial Items Completed

City Council meeting results for the above referenced items can be found on the City's website at the following address:

<http://clerkdoc.sannet.oov/Website/council-meeting-results>

19. The City's Financial Reporting Oversight Board should be eliminated as redundant to the Audit Committee. (Page M-6)

Status: City Council action complete. At its December 6, 2006 City Council meeting, the Council directed the City Attorney to eliminate the Financial Reporting Oversight Board (FROB) as redundant to the temporary Audit Committee.

The City Attorney's Office is planning to complete this action with other code changes which would reassign the FROB responsibilities, and define the Audit Committee responsibilities further. Anticipated completion date is April 2007.

21. The Audit Committee should meet quarterly, or more often if necessary, with the City's independent auditors, the City's Auditor General and the CFO. (Page 252)

Status: The Council amended the Meetings of the City Council and Standing Committees for the period January 1, 2007 through December 31, 2007 to add the Audit Committee (Council item 332c). Ten meetings are scheduled for calendar year 2007.

City Council meeting results for the above referenced item can be found on the City's website at the following address:

<http://clerkdoc.sannet.oov/Website/council-meeting-results>

Remedial Category – Ethics

42. To discourage any improper influence of the professionals who serve as "gatekeepers" to the public financial reporting process of the City, the Municipal Code should be amended to add criminal penalties for such conduct. It should be unlawful for any elected official, or employee of the City, or anyone acting under their direction, to take any action to corruptly influence, coerce, manipulate or mislead any independent certified public accountant engaged in the performance of an audit of the financial statements of the City or its component units, or outside legal counsel performing services for the City in connection with an offering statement of the City, or any actuary performing an actuarial valuation in connection with the preparation of the City's or SDCERS's CAFRs, or employees of a bond rating agency performing a credit rating of the City's bonds. (Page M-6)

Status: City Attorney action complete. The City Attorney prepared an ordinance and submitted it for City Council Action on November 1, 2006. On November 13, 2006, at the Special City Council Financial Hearing, the ordinance was referred to the Rules Committee. The Rules Committee is currently coordinating with the City Attorney's Office to docket the item. The ordinance should be reviewed at a February or March Rules Committee meeting.

I. Remedial Items Completed

002037

Remedial Category – Budget Policies and Practices

43. In order to maintain current service levels and address issues such as deferred maintenance, the City must reduce expenditures by improving efficiency, increasing the current revenue base, and seeking alternative revenue sources. (Page M-14)

Moved to Pg 4

Status: ~~Mayoral action complete.~~ *In-process* Supporting data described below will be included in the 2008 budget to be submitted to the City Council on April 13, 2007.

I presented the City's first five-year financial plan to the City Council on November 29, 2006. The plan addresses deferred maintenance, reducing expenditures via various methods, such as, elimination of positions; business process engineering and streamlining; employee benefit adjustments; debt refinancing; budget clean-up; release of encumbered funds; transfer of inactive fund balances; establishing a property business improvement district; leveraging city assets and managed competition. Revenues are projected to increase through normal growth.

I realize that the Financial Outlook is only a tool to help produce a comprehensive, long-range analysis of the City's general fund revenues and expenditures. The five-year financial outlook will be regularly updated and will be used to assist with the preparation of the City's annual budget. The plan can be accessed on the City's website at:

http://www.sandiego.gov/mayor/pdf/five_year_plan_11_15.pdf

Remedial Category – Disclosure

51. The City Attorney or City Attorney staff member should collect information relevant to public filings and bond offerings and should confirm, in writing, the accuracy of this information in the City's public documents. (Page M-25)

Status: Complete (internal control operating effectiveness to be tested upon the City's issuance of public filings or bond offerings). The Disclosure Practices Working Group (DPWG) adopted Controls and Procedures in October 2005 (refer to Attachment D) that require the City Attorney's Office to collect information relevant to public filings and bond offerings and to confirm, in writing, the accuracy of this information.

52. The City Council should have at least two weeks to review substantially completed drafts of a preliminary offering statement before it is asked to vote to approve the final document. (Pages 263 & M-14)

Status: Complete. The DPWG adopted Controls and Procedures in October 2005 that require it to provide the City Council over two weeks of review time before the City Council is asked to approve final offering documents. Refer to Article VI of the DPWG Controls and Procedures which are included as Attachment D.

I. Remedial Items Completed

In the most recent offering statements (Ballpark Refunding and Water System Financing), the City Council was provided with over three weeks of review time. Documentation of over three weeks of lead time is included in the following Independent Budget Analyst (IBA) Reports.

- IBA Report Number: 07-7, Refunding of the Ballpark Bonds
- IBA Report Number: 07-8, Subordinated Water Revenue Notes, Series 2007A

53. The DPWG should report to the City's new Audit Committee. (Pages 249 & M-5)

Status: Mayoral task complete. The Mayor's Office previously submitted a Request for Council Action that the City Council direct the City Attorney to amend the Municipal Code for certain changes to the DPWG (refer to Council item 330 and my memorandum dated November 22, 2006). At the December 6, 2006 Council meeting, the item was continued until the independent monitor/consultant is hired and could provide input.

I recommend that the Council add the requirement to item 330 that the DPWG meet periodically (on an as needed basis) with the City's new Audit Committee to discuss the City's disclosure controls and procedures.

Remedial Category – Information Technology, Financial Reporting Systems

71. The City should implement and utilize an automated financial reporting system to prepare the financial statements and complete the year-end closing. The City should maintain documentation supporting adjustments to facilitate the review of financial data. (Page M-15)

Status: Short-term plan complete. To facilitate automated financial reporting and financial documentation, the City completed the production phase of the data warehousing and business intelligence project on January 5, 2007. The application can be accessed via the following link:

<http://intra.sannet.gov/businessobjects/loqon.do>

The long-term plan to remediate Kroll item 71 is the implementation of an Enterprise Resource Planning (ERP) system. Refer to item 67 in section II.

Remedial Category – information Technology, E-Mail Systems

73. All City "Post Offices" should be centrally operated, maintained, and backed up. Consolidating systems and personnel will improve economy and ease maintenance. It will also ensure consistent data retention systems, policies, and procedures are used for City information. (Page M-26)

I. Remedial Items Completed

Status: Short-term plan complete. The short-term plan was to update the e-mail records retention policies. The long-term plan is the migration of the City's e-mail systems to Microsoft Outlook/Exchange and into one centrally managed system. The original due date for Microsoft Outlook/Exchange and one centrally managed system was June 2007. This has been revised to September 2007.

For background information, in early 2006, the Mayor created an e-mail task force to evaluate e-mail retention policies and system practices across City government. As a result of these efforts, the task force concluded that there were two distinct pieces of e-mail retention: records management and disaster recovery. After careful review, it was determined that the existing records management policies were acceptable, but that disaster recovery policies (that required keeping backups of all e-mails for just two weeks) required modification.

To that end, the task force recommended and the Chief Information Officer implemented (in October 2006) a revised procedure of retaining backups of the e-mail system for six months with a provision for extraordinary circumstances. During extraordinary circumstances (as determined by the Mayor and his advisors, "special circumstances" include external investigations, law suits, etc.), the six month window for maintaining backups can be extended until the special circumstances have elapsed.

Remedial Category – Procurement

82. The City should review procurement procedures to ensure compliance with all applicable policies, the proper segregation of duties, and the proper safeguard of requisition forms. (Page M-24)
-

Status: Complete (internal control operating effectiveness to be tested by March 31, 2007). On October 9, 2006, the Purchasing and Contracting (P&C) department was created to centralize, consolidate and streamline procurement resources and processes associated with contract pre-award operations for commodities, services, consultant and construction into one department (refer to City Council item 150). Policies and procedures have been drafted and are pending formal adoption for non-engineering consulting services which require contract execution by P&C. Additionally, a Designation of Authority memorandum was issued on November 2, 2006 to delineate persons who have the authority to initiate and negotiate a contract, lease, or other document or amendment, as well as persons who have the authority to sign and award contracts.

A formal documented process for P&C has been completed for compliance with Municipal Code item 22.3223. This requires that the City Council approve awards of contracts exceeding \$250,000 to a single consultant during any fiscal year. Documentation includes an internal control matrix, process flow, process narrative and identification of significant control activities.

I. Remedial Items Completed

Additionally, user profiles within OPIS (Online Procurement Information System) have been remediated to ensure the proper segregation of duties. Finally, Central Stores Department Instruction Number DA-1.01 was issued to ensure the proper and accurate issuance and handling of City financial requisition forms.

Remedial Category – Risk Management

89. The City should improve monitoring of Workers' Compensation cases and ensure that payments are made in a timely manner to avoid penalties. (Page M-24)

Status: Complete. The City's Risk Management Department has improved the monitoring and processing of workers' compensation permanent disability penalty payments. This remediation item is the result of a finding by Macias Ginni & O'Connell during its fiscal year 2004 financial statement audit. The finding relates to a 10% penalty that is required on any permanent disability payment that is more than 14 days after the last temporary disability payment. The City's improvement in reducing penalty incidents and amounts is shown below:

Fiscal Year	Penalty Incidents	Penalty Amounts
2003	302	\$90,991
2004	253	\$57,350
2005	144	\$34,827
2006	134	\$37,337
2007*	45 or 90 annualized *	\$10,786 or \$21,572 annualized *

* The penalty incidents and amounts for fiscal year 2007 are for the first six months of the year (July-December 2006). The penalty incidents and amounts have been annualized, by multiplying by two, for comparison purposes to prior fiscal years.

Remedial Category – Training

96. Funding should be added to the budget to ensure adequate training of personnel to ensure that they remain current on financial reporting standards. (Pages 246 to 247)

Status: Continual. Many of the accounting staff within the Auditor & Comptroller's Office has gone to at least one training session during this fiscal year. Specific funding will be included in the fiscal year 2008 budget for additional training opportunities in both this Auditor's budget as well as in the Financial Management.

I. Remedial Items Completed

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Remedial Category – SDCERS Financial Reporting

97. The Audit Committee concurs with actions being taken by the Retirement Administrator to establish a financial reporting function within SDCERS. (Page M-9)

Status: Complete. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E).

Remedial Category – SDCERS Internal Controls

98. SDCERS should develop a comprehensive methodology to identify, track, and recover overpayments made to deceased pensioners. (Page M-25)

Status: Complete. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E). I will forward my recommendation to the SDCERS' Board that this item be tested for internal control operating effectiveness no later than fiscal year 2008. Additionally, I recommend that the internal control testing results and documentation be presented to the SDCERS Audit Committee.

Remedial Category – SDCERS Actuarial Services

99. SDCERS should rebid the contract for the performance of its actuarial valuation every five years and that the actuary not be engaged for more than two five-year terms. (Pages 260 & M-12)

Status: Complete. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E).

Remedial Category – SDCERS Investment Advisors

100. SDCERS should require its investment consultants and fund managers to annually complete a Vendor Disclosure Form that calls for disclosure of all information regarding remuneration paid or received related to funds managed for SDCERS, as well as its business dealings with the SDCERS investment consultant. (Pages 258 & M-10)
101. Investment consultants and managers should be advised that a failure or delay in filing the annual disclosure will result in a penalty, including termination of services. (Pages 258 & M-10)

Status: Complete. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E). I will forward my recommendation to the SDCERS' Board that these items be tested for internal control operating effectiveness no later than fiscal year 2008. Additionally, I recommend that the internal control testing results and documentation be presented to the SDCERS Audit Committee.

Remedial Category – City Funding of SDCERS

103. The City should contribute to SDCERS annually the Annual Required Contribution, as calculated by SDCERS actuary, including an amount sufficient to amortize existing UAAL over a reasonable period of time that assures that current taxpayers are paying for the full cost of services rendered by employees of the City and not passed on to future generations. (Pages 259 & M-11)

Status: Complete. The Mayor's Five Year Plan contains full ARC (Annual Required Contribution) contributions over an amortization period in compliance with the "Gleason Settlement." The City's budget for fiscal year 2007 contains a contribution of \$162 million to pay the full ARC. This contribution was made at the beginning of the fiscal year (July 2006).

Additionally, the plan for fiscal years 2008-2012 provides for payment of ARC plus to eliminate negative amortization of the UAAL (Unfunded Actuarial Accrued Liability). The ARC plus contribution amounts to an additional \$27.1 million annual contribution over this period, or \$135.5 million in total.

The survey results can be accessed on the City's website at:

http://www.sandiego.gov/mayor/pdf/five_year_plan_11_15.pdf

106. The City should not use its contribution to pay for any benefits other than retirement benefits and the related costs of administering the Plan. Thus, no portion of the City's annual contribution to SDCERS should be credited against the City's obligation to pay retiree healthcare costs, or for any other of the so-called "Waterfall" payments, unless and until the City pays the required ARC. (Pages 259 & M-11)

Status: City Attorney action complete. The Municipal Code change to repeal the "Waterfall" payments is in the process of being docketed.

Remedial Category – SDCERS Organizational Structure

113. The controlling legal documents must make the Board's authority clear related to investment policy, actuarial assumptions, system budget and policies, retention of outside professionals, and administrative rules. (Page M-25)

Status: Complete. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E).

I. Remedial Items Completed

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Remedial Category – SDCERS Staff Qualifications

114. The chief accounting officer of SDCERS should have adequate prior experience with investment operations and financial reporting and disclosures. (Pages 258 & M-10)

Status: Complete. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E).

Remedial Category – SDCERS Board Structure

119. SDCERS should have standing committees to address board governance, compensation and evaluation of the Retirement Administrator, investments, and an audit and compliance committee. (Pages 256 & M-9)
121. SDCERS must be free to retain its own independent legal counsel. (Pages 260 & M-12)

Status: Complete. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E).

A. Items In-Process Previously Reported

Kroll Item #	Kroll Category	Memorandum Reference	Updated status?
13-14	Organizational Structure	October 5, 2006	No
20, 22-23	Audit Committee, Formation and Duties	October 30, 2006	Yes *
44	Budget Policies and Practices	October 30, 2006	Yes *
52.1, 52.2	Disclosure	October 5, 2006	No
58-59, 64-65	Financial Reporting	November 22, 2006	No
75-80	Internal Controls	November 22, 2006	No
81	Personnel	November 22, 2006	No
83	Redevelopment Authority	November 22, 2006	No
86	Reconciliation of Accounts	October 5, 2006	No
87	Retirement Benefits	October 30, 2006, November 22, 2006	Yes *
88	Risk Management	November 22, 2006	No
90, 95	Training	November 22, 2006	No

* see below.

Remedial Category – Audit Committee Formation and Duties

20. The Audit Committee should establish a written charter. (Pages 251 & M-6)
22. The Mayor, CFO, City Attorney, *Independent Budget Analyst (added)* and City Council should have the authority to make requests of the Audit Committee and Auditor General to perform internal audits of material matters they reasonably believe to be warranted. (Page 252)
23. With the assistance of the CFO and Auditor General, the City's independent auditors would be retained by, report to and take direction from the Audit Committee. (Page 252)

Updated Status:

In process. The temporary Audit Committee was created by the City Council during its January 9, 2007 Council meeting (refer to section I of this memorandum). The Audit Committee is in the process of establishing a written Charter that will address its duties and responsibilities. The Audit Committee is required to develop and recommend a Charter containing the duties and responsibilities of the Committee for further discussion and approval by the City Council by April 9, 2007 (90 days from January 9, 2007).

Remedial Category – Budget Policies and Practices

44. Ongoing expenditures should be supported by ongoing revenues; capital projects should identify all future cost considerations and financial impacts, including direct

II. Remedial Items In-Process

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and indirect costs for each Enterprise Fund; activities supported by user fees should be fully cost recoverable; discretionary General Fund revenues should not be earmarked; increase the General Fund reserve to the range of 7-10%; budget development should be guided by a long term or strategic plan proposed by the Mayor and adopted by the City Council; and after adoption, annual budgets should be amended only for urgent needs. Specific funding sources should be identified to pay for these needs. (Pages M-14 & M-15)

Updated Status: A draft General Fund reserve policy was presented to the Budget and Finance Committee during its November 29th Committee meeting. The draft policy identifies a reserve account, separate from the "deep reserves," which will serve as a contingency for unanticipated expenses approved by City Council during a given fiscal year. It is anticipated that the General Fund policy will be finalized and presented to the full City Council by June 2007.

Remedial Category – Retirement Benefits

87. The City Council and employees should develop realistic retirement plan parameters for future City hires. This includes positioning the City to attract and retain the talent needed to meet the citizens' expectations for services, not be viewed as providing excessive benefit levels, and creating a plan the City can afford. (Page M-25)

Status: Partially Complete. To address this item, the City is performing the following three evaluations:

- Actuarial evaluations of the cost implications of formula changes to the existing retirement systems (in-process)
- Benchmark study of Police Compensation and benefits for all employees (complete, see below)
- Benchmark study of Fire Compensation and benefits for all employees (in-process)

On December 21, 2006, the City issued an independent and comprehensive study of "The City of San Diego Police Classification Compensation and Benefits Survey Results." The Fact Sheet can be accessed on the City's website at:

http://www.sandiego.gov/mayor/pdf/fs_pdpav.pdf

The survey results can be accessed on the City's website at:

<http://www.sandiego.gov/mayor/pdf/pdsurvey.pdf>

On February 14, 2007, the City issued an independent and comprehensive study of "The City of San Diego Fire Classification Compensation and Benefits Survey Results." The Fact Sheet can be accessed on the City's website at:

http://www.sandiego.gov/mayor/pdf/fire_survey_2_15.pdf

B. Items In-Process During this Reporting Period**Remedial Category – Information Technology, Financial Reporting Systems**

67. By June 30, 2007, evaluate the information technology needs of the City, including benchmarking of existing systems against available systems suitable for management of the City's finances and the preparation of timely and accurate CAFRs and budgets. (Pages 247 & M-3)

Status: In-process. As background information, for the majority of its financial and accounting functions, the City currently relies on mainframe-based systems, many of which were developed more than 30 years ago.

The City recently completed a detailed Enterprise Resource Requirements plan prior to issuing a Request for Proposals (RFP) on January 19, 2007 to replace its aging financial and information management systems. As early as the City's 2001 Information Technology Strategic Plan, the City recognized a requirement to evaluate options for replacing core financial and human resources systems.

The City plans to select an Enterprise Resource Planning (ERP) vendor by March 2007. The news release for the RFP can be accessed on the City's website at:

http://www.sandiego.gov/mavor/pdf/erp_factsheet_1_19.pdf

Additionally, on February 5, 2007, the City Council adopted item 201 "Approving in Concept a Project to be Known as the Enterprise Resource Planning Core System."

Remedial Category – SDCERS Financial Reporting

102. The Retirement Administrator and CFO of SDCERS should annually include in the SDCERS' CAFR a signed management report on the financial statements and disclosures which include a statement of SDCERS' responsibility for establishing and maintaining an effective system of internal control over financial reporting and disclosures; a statement setting forth SDCERS' assessment of the effectiveness of the internal controls; a statement that based on their knowledge, the CAFR does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the CAFR not misleading; and a statement that the financial statement and other information included in the CAFR fairly present in all material respects the net assets and activities of SDCERS for the period presented. (Pages 257 & M-9)

Status: In-process. Refer to SDCERS letter dated January 31, 2007 regarding the ~~Status of Kroll Remediation (see Attachment E). SDCERS intends to include~~ a management report on the financial statements and disclosures (that meet the requirements of Kroll item 102) with its 2006 Comprehensive Annual Financial Report (CAFR).

II. Remedial Items In-Process

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Remedial Category – City Funding of SDCERS

104. For purpose of calculating annual funding requirements, the UAAL should reflect a prudent view of economic reality and include within it the costs of the Corbett settlement. (Pages 259 & M-11)

Status: In-process. SDCERS Board action approved and directed the actuary to include the costs of the Corbett settlement and 13th check. The Actuary report dated January 2007 contains these components in the UAAL. The Actuarial Valuation Report was presented at the SDCERS board meeting dated January 19, 2007. The link to the SDCERS board meeting agenda follows:

http://www.sdcers.org/agendas/2007/january/bd_admin_1_19_07.pdf
(refer to page 6, item IV.A.1)

The January 2007 Actuarial Report can be accessed on SDCERS website at:

http://www.sdcers.org/images/pdf/city_of_san_diego_actuarial_valuation_report_1_12_07_final.pdf
(refer to pages 29 and 31)

In addition, at its February 2007 Board Meeting, the SDCERS Board heard recommendations from Cheiron regarding changes to the amortization schedule. The Board is expected to make a final decision at its March meeting. Other actuarial assumptions will be considered in 2008.

Remedial Category – SDCERS Organizational Structure

112. To address Board authority and pursue administrative excellence, the controlling documents should be reviewed and, if necessary, modified to ensure that the Board has the necessary tools available to effectively and efficiently carry out its fiduciary duties. (Page M-25)

Status: In-process. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E).

Remedial Category – SDCERS Board Structure

120. SDCERS should adopt a formal charter for each committee which should be updated no less frequent than every three years. Pages 257 & M-9)

Status: In-process. The Audit Committee's charter has been adopted. Charters are being drafted for the other standing committees. Refer to SDCERS letter dated January 31, 2007 regarding the Status of Kroll Remediation (see Attachment E).

PROFESSIONAL EXPERIENCE**CITY OF PASADENA, CALIFORNIA**

- Department of Finance
Director of Finance

January 1996 to January 2006

Direct all aspects of the City's financial operations including its Electric and Water Utilities, Redevelopment Agency, Housing Authority, and Health Department. Prepare the City's \$508 million operating budget. Oversee the investment of nearly \$400 million in City funds. Responsible for purchasing, payroll, accounts payable, general accounting, information technology, and risk management. Prepare five year financial plans for the General Fund and Redevelopment Agency and ten-year financial plans the Electric Utility and Library Funds, assist in short and long-term planning. Handle the issuance and management of all debt; review and analyze potential business ventures for the City; participate in labor negotiations; and work closely with the City Council, providing it with continual financial information and guidance regarding the City's economic activities and outlook. During my tenure with the City of Pasadena, have issued over \$400 million in debt, including revenue bonds, pension obligation bonds, tax allocation bonds, certificates of participation, and Mello-Roos bonds.

MARICOPA COUNTY, ARIZONA

- Department of Finance
Manager of Finance

November 1994 to August 1995

Planned, organized and directed the operations of the Department of Finance. Assigned work responsibilities to 59 professional and support staff; recommended and developed fiscal policy and procedures; established and monitored fiscal control procedures; prepared financial reports; analyzed the financial impact of proposed legislation; and work with all County department on various fiscal issues. Participated in the negotiations of a multi-year, multi-million dollar contract to privatize the County Hospital patient billing system.

CITY OF RICHMOND, CALIFORNIA

- Office of the City Manager
Interim City Manager

February 1993 to January 1994

The City of Richmond has a nine member City Council, over 1,250 full time and part time employees and an annual operating and capital improvement budget of nearly \$220 million. Worked closely with the Mayor and City Council on all City related issues, implemented Council policies, served as intermediary between staff and the Council, worked with the 39 neighborhood councils, implemented Community Policing; completed the Environmental Impact Report (EIR) on the City's General Plan update; completed an EIR on a \$750 million Clean Fuels Project for a Chevron Refinery; negotiated financial and employment agreements with Chevron as part of its Project; negotiated development agreements, developed a balanced budget in light of State revenue transfers, developed and implemented various ordinances in order improve public beautification; and developed a public relations campaign in order to both improve the City's image and promote economic development.

- Department of Finance
Director of Finance

May 1988 to November 1994
(except as noted above)

Directed all aspects of the City's financial operations including its Port, Redevelopment Agency, and Housing Authority. Prepare the City's \$220 million operating and capital improvement budget. Oversaw the investment of City funds. Responsibility for purchasing, payroll, accounts payable, general accounting, and risk management. Under my direction, the City developed a five year financial plan to assist in short and long-term planning. Handled the issuance and management of all debt; reviewed, analyzed and participated in the negotiations of potential business ventures for the City; participate in labor negotiations; and work closely with the City Council, providing it with continual financial information and guidance regarding the City's economic activities and outlook.

CITY OF SANTA CLARA, CALIFORNIA

- Finance Department
Assistant Director of Finance

October 1985 to May 1988

Coordinated the preparation and presentation of the City's \$260 million budget. Supervised the daily investment of the City's \$200 million portfolio. Implemented the City's on-line Financial Management Information System, including validating System accuracy, establishing System balancing control procedures, revising operating and accounting procedures, and training City staff. Issued and managed debt. Prepared, monitored, and updated the City's five-year financial plan. Worked with City departments on financial related issues. Performed cost studies.

SAN MATEO COUNTY, CALIFORNIA

- Department of Community Services, Director's Office
Administrative Coordinator 1980 to 1985
- Department of Community Services, County Library
Management Analyst III 1979 to 1980
- Department of Health and Welfare
Management Analyst I/II/III 1976 to 1979

Prepared departments' budgets. Presented proposed budgets to Board of Supervisors. Prepared fiscal projections and monitored program revenues and expenditures. Negotiated and monitored contracts. Conducted studies and analyzed programs and services to determine cost effectiveness and usefulness. Established fiscal monitoring procedure to track both direct expenditures and the allocation of overhead to various funding sources.

EDUCATION

- | | | |
|---|-------------------------------|------|
| Master of Business Administration | University of Santa Clara, CA | 1983 |
| - Course emphasis in Finance | | |
| Master of Public Administration | Arizona State University | 1975 |
| - Course emphasis in Municipal Administration | | |
| Bachelor of Science | University of Minnesota | 1973 |
| - Triple major in Political Science, Economics, and Business Admin. | | |

PROFESSIONAL MEMBERSHIPS:

Issuers' Advisory Group of the Municipal Securities Ruling Making Board (MSRB)
Revenue & Taxation Committee - League of California Cities
State Controller's Advisory Group on Financial Reporting
Government Finance Officers Association
California Society of Municipal Finance Officers (CSMFO)
California Municipal Treasurers Association (CMTA)
Former Member of the CDLAC - Technical Advisory Committee for Debt

CITY OF SAN DIEGO

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Michael J. Aguirre

CITY ATTORNEY

Attachment B

September 1, 2006

REPORT TO THE HONORABLE
MAYOR AND CITY COUNCIL

RE: REMEDIATION MEASURES REQUIRING CHANGES TO THE CITY CHARTER,
AND RELATED MATTERS

INTRODUCTION

The "Report of the Audit Committee of the City of San Diego" [Kroll Report] was presented to the San Diego City Council at its meeting on August 8, 2006. The report suggests serious deficiencies in the City's financial reporting obligations and proposes numerous remediation measures.

On August 24, 2006, the Mayor issued a plan to implement certain remedial measures. [Mayor's Report]. The Mayor's plan will be considered by the City Council at a special meeting on September 6, 2006.

The Kroll recommendations incorporated in the Mayor's plan include some items that would significantly change the City's auditing and financial reporting structure. The Mayor's report acknowledges that some Charter changes will be required to implement the recommendations.

Among other concerns, the recommendations to the Council suggest new committees and outside individuals be vested with decision making authority previously exercised by, and legally reserved to, elected officials. These types of changes conflict with the City Charter and, prior to implementation, will require a vote of the electorate on specific Charter amendments.

Failure to obtain the required Charter modifications prior to implementation would result in actions taken in excess of the jurisdiction of the offices of the Mayor and/or City Council (*Ultra vires* acts) rendering all such acts "void" from inception. Such actions could subject the City to liability for actions taken, or not taken, by persons asserting authority where none has been legally granted; subject persons acting under such deficient authority to exposure for which there would be none of the immunities associated with government service; and further complicate the ability of the City to resolve its issues with federal regulators and to re-enter the capital markets.

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This initial report will highlight, by example, some of the suggested remediation measures that require changes to the City Charter and will provide recommendations for further action. In particular, this report focuses on:

1. Changes to the composition of the San Diego City Employees' Retirement System Board of Administration;
2. Changes to the Office of the City Auditor and Controller;
3. Creation of an "Audit Committee";
4. Appointment of a "Monitor"; and
5. Changes to the jurisdiction of the Office of the City Attorney to eliminate that office as attorney for the Retirement System.

DISCUSSION

I. The City Council may not Impact, by Ordinance, Charter-Established City Departments or Charter-Established Duties of City Officials.

A charter is the supreme law of a city, subject only to constitutional limitations and preemptive state law. *Domar Electric, Inc. v. City of Los Angeles*, 9 Cal. 4th 161, 170 (1994). "[I]t is well settled that a charter city may not act in conflict with its charter," and that "[a]ny act that is violative of or not in compliance with the charter is void." *Id.* at 171. This means that the City Charter's authority is greater than the authority of any ordinance enacted by the City's legislative body, the City Council. Should an ordinance or other action by a City Council conflict with what the charter provides, the City Council's action is void and unenforceable.

The City Council has the authority to place measures before the voters that propose changes to the City Charter, either at its own discretion, or as mandated after the presentation of certain certified voter petitions. *See, Howard Jarvis Taxpayers Assn. v. City of San Diego*, 120 Cal. App. 4th 374, 377-380 (2004). The actual changes to a City Charter may only occur by a vote of the electorate.

Established legal authority and City Charter section 26 preclude any Council action by ordinance that seeks to change a charter-established *department* of the City or a charter-established *duty* of a city official. Charter section 26 provides in pertinent part:

The Council shall by ordinance, by majority vote, adopt an administrative code providing for the detailed powers and duties of the administrative offices and departments of the City Government, based upon the provisions of this Charter. Thereafter,

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except as established by the provisions of this Charter, the Council may change, abolish, combine, and rearrange the departments, divisions and boards of the City Government provided for in said administrative code, but such ordinance creating, combining, abolishing or decreasing the powers of any department, division or board shall require a vote of two-thirds of the members elected to the Council. The Council may by ordinance, if authorized so to do by the general law of the State, provide that any function of the City may be performed by the County or that any function of the County may be performed by the City, provided the respective legislative bodies authorize and approve such transfer and assumption of function. There may also be established a combined City and County district for the performance of any function. [Emphasis added].

Section 26 was assessed in *Hubbard v. City of San Diego*, 55 Cal. App. 3d 380 (1976). The court found that: "... the power of the council to 'change, abolish, combine, and rearrange the departments, divisions and boards of the City Government provided for in said administrative code' is limited by the words 'except as established by the provisions of this Charter.'" *Id.* at 387. The court then held, most unequivocally that:

We face the problem whether the council, under the charter, may create a department of city government not provided for by the charter and remove it from the supervision and control of the manager by designating that department a legislative department without regard to the powers and duties attempted to be given to it.

We hold that the council cannot do so.

The council may not create a department of the city government, by whatever name it is given, which duplicates or infringes upon the specific powers or duties assigned by the charter to another department or, generally, to the manager." *Id.* at 388. [Emphasis added].

Another San Diego case, *Dadmun v. City of San Diego*, 9 Cal. App. 549 (1908), prohibits the City Council from transferring the duties given to a city officer by the charter to another by ordinance. In *Dadmun*, the City Council passed an ordinance creating the office of special prosecutor to prosecute only municipal ordinance violations. The City Charter at that time provided that the prosecution of municipal ordinances was the duty of the City Attorney. The Court held that "the city council cannot relieve a charter officer of the city from the duties devolving upon him by the charter and designate another to perform those duties It follows, then, that the action of the city council in appointing a special prosecutor whose duty it should be to prosecute criminal violations of ordinances was unauthorized and void" *Id.* at 551.

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These court decisions and City Charter section 26 limit the City Council's ability to take action by ordinance to implement the suggested "remediation measures" that conflict with existing Charter provisions establishing or assigning duties to City departments or officials. They similarly preclude the Mayor's office from implementing those changes administratively prior to Charter revision by the electorate.

II. Changes to the Composition of the San Diego Retirement Board of Administration.

The Kroll report recommends several changes involving the San Diego City Employee Retirement System. One of the proposals is to change the size and composition of the Board that administers the System. Kroll Report, Appendix M-8. City Charter section 144 governs the composition of that Board. This proposed change conflicts with the existing charter. A change to the City Charter is required in order to change the composition of that Board.

III. Changes Impacting the Office of Auditor and Comptroller.

The Kroll report recommends several changes that will impact the Office of the Auditor and Comptroller as it now exists. The duties of the Auditor and Comptroller are broad and varied under the City Charter and the San Diego Municipal Code. A partial summary of those duties is included in a memorandum prepared by this Office entitled "The Relationship between the City Offices of the Mayor and the Auditor and Comptroller under the Mayor-Council Form of Government" (January 23, 2006), a copy of which is attached. The proposed remedial measures eliminate the position of the Auditor and Comptroller and create five (5) new offices: an Auditor General, a separate City Comptroller, a Director of Financial Reporting, a Director of Financial Management, and a Director of Debt Management. It may also be appropriate to amend the Charter to clarify the role of the Chief Financial Officer.

The suggested restructurings in these offices will require amendments to the City Charter.

IV. Creation of an Audit Committee.

The Kroll Report recommends the creation of a three-member Audit Committee, consisting of two citizen members and one member of the City Council. The two citizen members are to be appointed by the Mayor with Council confirmation, and will receive compensation. Appendix M-6. The Kroll report recommends that the City's independent auditors "should be retained by, report to, and take direction from, the Audit Committee." *Ibid.* The Committee is to be given the power to select and retain independent auditors, who will report only to it. *Ibid.* The City's Financial Oversight Board is to be eliminated as redundant to the Audit Committee. *Ibid.*

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The Kroll Report recommends that the proposed new Auditor General report to the Audit Committee. The Audit Committee would set this official's annual compensation and the annual budget of this official's new department. The Auditor General can be removed from office for cause by the Audit Committee or upon the vote of three-quarters of the City Council. Appendix M- 5.¹

The suggestion that the Audit Committee have the authority to set salaries and/or budgets conflicts with City Charter section 11.1, and related sections. Section 11.1 expressly forbids the City Council from delegating its responsibility to adopt ordinances to raise or spend public money, including "the annual budget ordinance, or any part thereof, and the annual ordinance setting compensation for City employees." *Also see* § 290 [City Council must set and adopt the terms of the salary ordinance and the City Budget]. The City Charter requires the City Council to approve the range of compensation for all City officials and the budget for all City departments. As noted in Part I above, the City Council may *not* by ordinance create an Audit Committee and provide it with powers that conflict with the Council's charter-required duties. This may only be accomplished by a change to the Charter.

If the Audit Committee is intended as an advisory committee, its proposed duties also conflict with another Charter section. The Kroll Report recommends the citizen members of this committee receive compensation. This recommendation conflicts with section 43(a) which forbids such compensation: "The members of such boards shall serve without compensation . . ." City Charter § 43(a). However, this may not become an issue as the Mayor's Report indicates that: "It is anticipated that members of the Audit Committee will not be compensated for serving on the Committee. *See, Mayor's Report, p. 5.*

The Kroll Report also recommends the Audit Committee retain and direct the City's independent auditors; and the Committee is to have ultimate authority over the office of Auditor General, including the absolute right to set the salary for the City Official and the budget for the department, and to remove this City Official for cause. This authority also conflicts with section 43(a) which provides: "The members of such boards shall . . . not . . . direct the conduct of any Department or Division."

The creation of the Audit Committee requires changes to the City Charter. The Mayor's suggested timeline for the creation of this committee must necessarily be deferred to coincide with the remainder of the ballot proposals for the November, 2008 election.

¹ This position was reiterated by the authors of the Kroll report in an article August 30, 2006 in the San Diego Union Tribune "An Opportunity to Move Forward." They stated: "The audit committee also sets the compensation and budget for the auditor, which should allow them to do their oversight without undue influence from any branch of government."

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V. Appointment of an Independent Monitor to Oversee the City's Remediation Plan.

The Kroll Report suggests the appointment of an independent "Monitor", a person who must have "complete and unfettered access to all City and SDCERS personnel and records." Appendix M-14. The SEC is to be given the right, whenever it chooses, to expand the duties of this Monitor. *Ibid.*

The Mayor's Report accepts this recommendation and indicates that the selection process has begun. The Mayor anticipates paying more than a million dollars a year for three years of this individual's services. Mayor's Report, p. 1. The Independent Budget Analyst recommends more public discussion on the necessity of this position, scope of work and funding requirements before the Council approves any contract for this individual. For several reasons, we agree that additional public discussion is essential to this process.

Under existing City Charter provisions, neither the Mayor nor the City Council may contract for the services of an individual that would include such a broad delegation of authority.

The Mayor has the authority under City Charter section 28 to hire certain experts and consultants. Those individuals contract with the City and receive their duties and direction from the City. The Monitor described in the Kroll report is plainly *not* such an individual.

Although the City would pay for this individual's services, the report contemplates that an outside agency would set the duties of this official, not the City. No aspect of the City Charter provides the Mayor or the City Council with the authority to select a private individual and provide them with "unfettered" access and authority over City affairs.²

² City Charter section 40 gives broad authority to examine the affairs of the City to only one City Official, the City Attorney. It provides: "The City Attorney shall have charge and custody of all legal papers, books, and dockets belonging to the City pertaining to his office, and . . . may demand and receive from any officer of the City any book, paper, documents, or evidence . . . required for the purpose of the office." The *Dadmun and Hubbard* cases provide that the City Council may not contract for the services of an individual and grant powers that conflict with the powers already given by the City Charter to a City Official. Accordingly, the appointment of an independent Monitor would require a Charter amendment.

Monitors may be appointed to oversee the implementation of court-ordered remediation plans and given jurisdiction over certain affairs of a City in a appropriately filed legal proceedings. Likewise, they may be included in certain administrative proceedings, "consent decrees" and the like. The City is in discussions with the Securities and Exchange Commission regarding securities related issues. It is not inconceivable that a "Monitor" will be a required element of the resolution of our efforts with that agency. In such case, the term of service, and the role, of the person serving as the City's Monitor will be tailored to the specifications of services deemed to be required by the SEC and that person will have authority under well established legal authority. Adopting the "Monitor" suggested in the Kroll Report is inconsistent with the grant of jurisdiction required by the City Charter. It also adds nothing to the resolution of the monitoring functions which may be required by the SEC, and may in fact conflict with that process.³

VI. Changes to the City Attorney as Attorney for the Retirement System.

The Kroll Report recommends that the City's retirement system be free to retain its own independent counsel. Appendix M-12. San Diego Charter section 40 lists the duties it requires of the City Attorney. One of them is that "*The City Attorney shall be the chief legal adviser of, and attorney for the City and all Departments and offices thereof* in matters relating to their official powers and duties, except in the case of the Ethics Commission, which shall have its own legal counsel independent of the City Attorney." [Emphasis added]. San Diego Municipal Code section §22.1801(b) designates "the departments of the City of San Diego within the meaning of the Charter and ordinances of said City." One of the City Departments is "City Retirement." The City Retirement System is a City Department. It follows that the City Attorney is the System's Attorney by City Charter mandate.

The City Attorney's duty to provide legal services to the City has historically included providing services to the retirement system. However, this issue is currently the subject of litigation, and will ultimately be resolved in that forum. In the meantime, the suggested recommendation to permit this City Department to retain independent counsel conflicts with the

³ Federal courts can utilize outside monitors to observe, examine and scrutinize public corporations, police departments, unions and even industries entering into comprehensive settlement agreements to avoid further prosecution for wrongdoing. These monitors are given specific direction and duties by the Court. To insure the monitor is fully independent of the entity which it is scrutinizing, the monitor is chosen, employed and subject to replacement only by the Court. The Court appointed monitor is required to provide the utmost of honesty and candor to the Court. Failure to do so could place the monitor itself in contempt.

In the typical settlement or remediation agreement, the monitor is required to periodically report its findings to the Court.

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plain language of Charter section 40. To transfer that duty to another person would require a change to the City Charter.

CONCLUSION

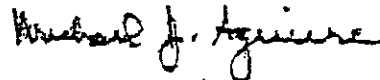
The recommendations in the Kroll Report involve complicated and interrelated changes to the City Charter and to many related portions of the San Diego Municipal Code. The changes will be more complex than the recent change to our trial Mayor-Council form of government.

The City needs to carefully consider the many ramifications. One of the most significant, for example, is whether these remediation measures should be enacted to coincide only with the duration of our Mayor-Council governance structure, due to expire in 2010.

This office has only begun to assess the legal ramifications of these recommendations in this initial and preliminary report. We expect there will be other remediation measures that may also require charter changes.

To avoid inadvertent implementation of the remediation measures in a manner precluded by law, we suggest the Council receive the Mayor's Report but take no immediate action on it as a whole. The Council should consider and ultimately decide which specific measures it wishes to move to implementation. Each such item will be the subject of prompt implementation advice from this office.

Respectfully submitted,



MICHAEL J. AGUIRRE
City Attorney

MJA:JAK:jk
RC-2006-25

Attachment

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OFFICE OF MAYOR JERRY SANDERS
CITY OF SAN DIEGO

MEMORANDUM

Date: April 9, 2007
To: Honorable Members of the City Council
From: Mayor Jerry Sanders *JPL*
Subject: Kroll Remediation Status Report Number 5, prepared for
April 23, 2007 Council Meeting

This is the Fifth in a series of status reports regarding Kroll Remediation efforts. To date, approximately 62 or 51% of the 121 Kroll remediation items have been completed, or are substantially complete and more than 35 additional items are in-process. Although the City has made tremendous progress to date, there are still many important items remaining to complete our Kroll remediation efforts. On April 23, 2007 my staff will meet with you to discuss the following:

- Status of remedial items completed or substantially completed as of April 9, 2007
- Status of remedial items in-process as of April 9, 2007
- Timeline modifications

The status of all Kroll remediation items will continue to be provided to Mr. Stanley Keller, Independent Monitor, for observations and comments. Any conclusions made by him will be provided to the City Council.

Cc: City Attorney
Chief Operating Officer
Chief Financial Officer
Stanley Keller, Independent Monitor
Independent Budget Analyst
SDCERS
John Dyer

Attachment A - Greg Levin resume, comptroller functions
Attachment B - Tracy McCraner resume, financial reporting functions
Attachment C - Kyle Elser resume, internal audit functions

002060 I. Remedial Items Completed or Substantially Completed

A. Items Previously Reported Completed or Substantially Completed

Kroll Item #	Kroll Category	Memo Reference	Additional Action Required		
			City Attorney	City Council	Mayor
1-6	Oversight Monitor	2/21/2007			
7-12	Organizational Structure	10/5/2006			
15	Staff Qualifications	2/21/2007			
18	Audit Committee – Formation and Duties (Long-Term Plan)	2/21/2007			Note A
19	Audit Committee – Formation and Duties (Eliminate FROB)	2/21/2007	Note B		
21	Audit Committee – Formation and Duties (Scheduled Meetings)	2/21/2007			
24	Audit Committee – Formation and Duties (whistleblower procedures)	10/30/2006		Note C	
42	Ethics	2/21/2007	Note D		
45	Budget Policies and Practices	10/30/2006			
46-47	City Actuarial Services	10/5/2006			
48(i)	Deferred Maintenance	10/5/2006			
49	Disclosure (DPWG)	11/22/2006		Note E	
51	Disclosure (City Attorney Confirmation)	2/21/2007			Note F
52	Disclosure (City Council Review Period)	2/21/2007			
53	Disclosure (DPWG and Audit Committee)	2/21/2007		Note E	
54-57	Financial Reporting	10/30/2006			
57.1	Financial Reporting	10/5/2006			
66	Forecasting/Projections	11/22/2006			
71	Information Technology – Financial Reporting Systems	2/21/2007			Note G
73	Information Technology – E-Mail Systems	2/21/2007			Note H
74	Interest Allocation	10/30/2006			Note F
82	Procurement	2/21/2007			Note F
84-85	Reconciliation of Accounts	10/30/2006			Note F
89	Risk Management	2/21/2007			
96	Training	2/21/2007		Note I	

I. Remedial Items Completed or Substantially Completed

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Kroll Item #	Kroll Category	Memo Reference	Additional Action Required		
			City Attorney	City Council	Mayor
97	SDCERS Financial Reporting	2/21/2007			
98	SDCERS Internal Controls	2/21/2007			
99	SDCERS Actuarial Services	2/21/2007			
100-101	SDCERS Investment Advisors	2/21/2007			
103	City Funding of SDCERS	2/21/2007			
106	City Funding of SDCERS	2/21/2007		Note J	
107-108	City Funding of SDCERS	11/22/2006			
107.1	City Funding of SDCERS	10/5/2006			
113	SDCERS Organizational Structure	2/21/2007			
114	SDCERS Staff Qualifications	2/21/2007			
119,121	SDCERS Board Structure	2/21/2007			

Notes:

- A. Establishment of a Charter Review Committee; part of the committee's responsibilities include the long-term Audit Committee plan
- B. City Attorney to eliminate Financial Reporting Oversight Board (FROB) as redundant to the new Audit Committee
- C. Audit Committee to assume selected areas of responsibility for "whistleblower" policies and procedures
- D. Improper influence Ordinance was submitted to the City Council by the City Attorney on November 1, 2006; the City Council referred it to the Rules Committee on November 13, 2006; the Rules Committee chair has returned the Ordinance to the City Attorney for clarification
- E. City Council action required to direct the City Attorney to modify the Municipal Code to change the membership of the Disclosure Practices Working Group (DPWG) and have the DPWG report periodically to the Audit Committee
- F. Internal control operating design is complete; operating effectiveness (testing) to be performed or completed
- G. Short-term plan complete; long-term plan to be completed as part of Enterprise Resource Planning (ERP) project
- H. Short-term plan complete; long-term plan scheduled for completion by September 2007
- I. The Mayor's proposed budget for fiscal year 2008 contains adequate funding for training of personnel to ensure that they remain current on financial reporting standards; City Council action required to approve the budget
- J. An amendment repealing the "Waterfall" was introduced to the City Council on March 5, 2007; a second reading of the amended Ordinance is scheduled for April 10, 2007; however, a memo dated April 5, 2007 requested the City Attorney perform additional legal analysis prior to City Council action

I. Remedial Items Completed or Substantially Completed

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B. Items Completed or Substantially Completed During this Reporting Period

Kroll Item #	Kroll Category	Memo Reference	Additional Action Required		
			City Attorney	City Council	Mayor
13-14 **	Organizational Structure (Comptroller and Director of Financial Reporting)	4/9/2007			
16-17	Organizational Structure (Staff Qualifications)	4/9/2007			
20	Audit Committee, Formation and Duties (written charter)	4/9/2007		Note K	
22	Audit Committee, Formation and Duties (audit requests)	4/9/2007		Note K	
23	Audit Committee, Formation and Duties (independent auditor retention)	4/9/2007		Note K	
104	City Funding of SDCERS	4/9/2007			
109-111	City Funding of SDCERS	4/9/2007			

** Further action is required via a Charter Change

Notes:

K. City Council action is required to approve the Audit Committee Charter

Remedial Category – Organizational Structure

13. Establish the position of City Comptroller responsible for accounting and financial reporting, including preparation of the CAFRs and reporting to the CFO. (Pages 245, 246 & M-2)
14. Establish the position of Director of Financial Reporting responsible for the preparation of the City's periodic financial statements. (Pages 246 & M-2)

Status: Substantially complete. The City has assigned qualified personnel to serve in the capacity of Comptroller (Deputy Comptroller until the Charter is amended) and Director of Financial Reporting (refer to items 16 and 17 below for staff qualifications). City management believes the establishment of permanent position of Comptroller will require an amendment to the City Charter and perhaps the Municipal Code.

Remedial Category – Staff Qualifications

16. The Comptroller should have significant experience in governmental accounting, including in the preparation of CAFRs in accordance with GASB and other applicable accounting and financial reporting standards, rules and regulations; should in particular be familiar with federal rules and regulations applicable to the

I. Remedial Items Completed or Substantially Completed

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receipt of federal assistance and the issuance of public securities; and should also be competent to design, implement and operate an effective system of internal controls over financial reporting and disclosure. (Page M-2)

Status: Substantially complete (refer to item 13 above). The City has assigned Mr. Greg Levin the responsibilities of Deputy Comptroller. Mr. Levin has experience in government accounting, including the preparation of CAFRs in accordance with applicable accounting and financial reporting standards. He is familiar with federal rules and regulations applicable to the receipt of federal assistance and the issuance of public securities. Mr. Levin also has experience with internal controls over financial reporting and disclosure. See Attachment A for Mr. Levin's resume.

17. The Director of Financial Reporting would report to the Comptroller and would be responsible for the preparation of the City's periodic financial statements. This person should also have experience in the preparation of the CAFRs in accordance with GASB and other applicable accounting standards, rules and regulations. (Page M-2)

Status: Substantially complete (refer to item 14 above). The City has assigned Ms. Tracy McCraner the responsibilities of Director of Financial Reporting. This position reports to the Deputy Comptroller. Ms. McCraner has significant experience in government accounting, including the preparation of CAFRs in accordance with applicable accounting and financial reporting standards. See Attachment B for Ms. McCraner's resume.

Remedial Category – Audit Committee, Formation and Duties

20. The Audit Committee should establish a written charter. (Pages 251 & M-6)
22. The Mayor, CFO, City Attorney and City Council should have the authority to make requests of the Audit Committee and Auditor General (Internal Auditor) to perform internal audits of material matters they reasonably believe to be warranted. (Page 252)
23. With the assistance of the CFO and Auditor General (Internal Auditor), the City's independent auditors would be retained by, report to and take direction from the Audit Committee. (Page 252)

Status: Substantially complete via Audit Committee Charter. The Audit Committee approved a Charter, as well as Standing Rules for the Municipal Code and Mayor's Statement of Operating Principles and forwarded them to the City Council for consideration. City Council approval of these items is required.

Although the intent of items 22 and 23 above are addressed in the Audit Committee's Charter, the Charter does not fully address all Kroil requirements. For example the Audit Committee Charter does not state that the CFO can make requests of the Audit Committee and Internal Auditor to perform certain audits. Additionally, the Charter does not state that the CFO or Internal Auditor have input with the Audit Committee's selection of the City's independent auditors. The Charter states that the Mayor shall provide

I. Remedial Items Completed or Substantially Completed

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appropriate consultation with the Audit Committee's selection of the City's independent auditors.

Remedial Category – City Funding of SDCERS

104. For purposes of calculating annual funding requirements, the UAAL should reflect a prudent view of economic reality and include within it the costs of the Corbett settlement. (Pages 259 & M-11)

Status: Substantially complete. SDCERS Board action approved and directed the actuary to include the costs of the Corbett settlement and 13th check. The Actuary report dated January 2007 contains these components in the UAAL. The Actuarial Valuation Report was presented at the SDCERS board meeting dated January 19, 2007. The link to the SDCERS board meeting agenda follows:

http://www.sdcers.org/agendas/2007/january/bd_admin_1_19_07.pdf
(refer to page 6, item IV.A.1)

The January 2007 Actuarial Report can be accessed on SDCERS website at:

http://www.sdcers.org/images/pdf/city_of_san_diego_actuarial_valuation_report_1_12_07_final.pdf
(refer to pages 29 and 31)

In addition, the SDCERS Board has directed its actuary to complete an experience study which will be presented to the Board in the winter of 2008. This study will provide the Board with information to make further assumption decisions such as the appropriate discount rate and salary growth SDCERS should use.

109. The City, in response to the Report of the Pension Reform Committee, amended the Charter to require net actuarial losses be amortized over a period not longer than 15 years, net actuarial gains over a period not shorter than five years, and that SDCERS use an amortization period no greater than a fixed, straight-line five years for each new benefit improvement. It is recommended that the City use the same period for amortization of both gains and losses. (Pages 261 & M-12)
110. The plan's actuary should be engaged to develop a responsible funding program that considers expected cash distributions and the obligations to new and existing plan members. (Page M-25)
111. The Pension Reform Committee assessed the pension plans under funded status and offered recommendations related to reducing or eliminating the City's UAAL and reducing the ongoing annual costs related to the plan and contingent benefits. The City should re-evaluate the Committee's recommendations and, beyond those previously addressed in our Report, consider enacting those that are appropriate that do not conflict with our Remediation Plan. (Page M-18, M-19 & M-20)

I. Remedial Items Completed or Substantially Completed

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Status:

Complete. At its March 16, 2007 Board meeting, SDCERS adopted a 20 year amortization schedule to pay off the current UAAL. As part of the motion, the actuary was instructed to ensure that his calculation did not include any negative amortization. In addition, the SDCERS Board adopted a 15 year amortization schedule for all future gains or losses and a five year amortization schedule for any new pension benefits approved by the City. This will take affect for the June 30, 2007 actuarial valuation which will be reflected in the City's fiscal year 2009 budget.

The Mayor has included a supplemental pension payment in his proposed fiscal year 2008 budget to ensure no negative amortization and the beginning payoff of the existing UAAL.

II. Remedial Items In-Process

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A. Items In-Process Previously Reported

Kroll Item #	Kroll Category	Memorandum Reference	Updated status?
43 ***	Budget Policies and Practices	February 21, 2007	Yes *
44	Budget Policies and Practices	October 30, 2006	No
52.1, 52.2	Disclosure	October 5, 2006	No
58-59	Financial Reporting	November 22, 2006	Yes **
64-65	Financial Reporting (accruals)	November 22, 2006	No
67	Information Technology, Financial Reporting Systems	February 21, 2007	Yes *
75-78	Internal Controls	November 22, 2006	No
79-80	Internal Controls	November 22, 2006	Yes **
81	Personnel	November 22, 2006	No
83	Redevelopment Authority	November 22, 2006	No
86	Reconciliation of Accounts	October 5, 2006	No
87	Retirement Benefits	October 30, 2006, November 22, 2006	No
88	Risk Management	November 22, 2006	No
90, 95	Training	November 22, 2006	No
102	SDCERS Financial Reporting	February 21, 2007	No
112	SDCERS Organizational Structure	February 21, 2007	No
120	SDCERS Board Structure	February 21, 2007	No

* see below

** see Section III

*** Item was previously reported as complete; however, based upon further review and discussions, item was moved back to in-process

Remedial Category – Budget Policies and Practices

43. In order to maintain current service levels and address issues such as deferred maintenance, the City must reduce expenditures by improving efficiency, increasing the current revenue base, and seeking alternative revenue sources. (Page M-14)

Updated Status: In-process. The Mayor's fiscal year 2008 takes the first significant steps towards reducing costs, improving efficiencies and funding the eight significant areas identified in the Five-year Financial Outlook, including deferred maintenance. While the fiscal year 2008 budget is balanced as proposed, and the funding gap in future years has been reduced, the City still has future budget challenges in order to meet its obligations and still provide current service levels.

The City's first five-year financial plan was presented to the Budget and Finance Committee on November 29, 2006. The plan addresses deferred maintenance, reducing expenditures via various methods, such as, elimination of positions; business process engineering and streamlining; employee benefit adjustments; debt refinancing; budget clean-up; release of encumbered funds; transfer of inactive fund

II. Remedial Items In-Process

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balances; establishing a property business improvement district; leveraging city assets and managed competition. Revenues are projected to increase through normal growth.

The Financial Outlook is only a tool to help produce a comprehensive, long-range analysis of the City's general fund revenues and expenditures. The five-year financial outlook will be regularly updated and will be used to assist with the preparation of the City's annual budget. The plan can be accessed on the City's website at:

http://www.sandiego.gov/mayor/pdf/five_year_plan_11_15.pdf

Remedial Category – Information Technology, Financial Reporting Systems

67. By June 30, 2007, evaluate the information technology needs of the City, including benchmarking of existing systems against available systems suitable for management of the City's finances and the preparation of timely and accurate CAFRs and budgets. (Pages 247 & M-3)

Updated Status: In process. On January 5, 2007 San Diego Data Processing Corporation (SDDPC) issued a Request for Proposals (RFP) for the Enterprise Resource Planning (ERP) system software. Two qualified proposals were received by the proposal due date of February 9, 2007. The ERP System Evaluation and Selection Committee are expected to make a vendor recommendation to the ERP System Core Project Executive Steering Committee in the third week of April 2007. Following the selection of the software vendor, a RFP will be issued for a System Integrator. The System Integrator is expected to be selected in June 2007.

B. Items In-Process During this Reporting Period

Remedial Category – Auditor General, Establishment and Responsibilities

25. Create a new position of Auditor General (Internal Auditor) with responsibility for internal audits of the City's internal controls, financial accounting, reporting and disclosure; operations; and fraud, waste and abuse. This person would be nominated by the Mayor and confirmed by the majority of the City Council. (Pages 250 & M-5)
26. The new Auditor General (Internal Auditor) should report to the Audit Committee no less than on a quarterly basis and periodically to the City Council and should submit annually to the City Council a public report of his/her activities. (Pages 250 & M-5)
28. The Auditor General (Internal Auditor) should report to the Audit Committee the results of any investigation and disposition of such complaints. (Page 252)
29. In accordance with the *International Standards for the Professional Practice of Internal Auditing*, the Auditor General (Internal Auditor) should establish risk-based plans to determine the priorities of the internal audit activity. (Page M-17)

II. Remedial Items In-Process

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30. The City should require the Auditor General (Internal Auditor) to adopt a comprehensive risk assessment and planning process that actively addresses financial reporting, accounting activities, and other issues. (Page M-25)
31. The Auditor General (Internal Auditor) should use a systematic and disciplined approach based on a risk assessment to select audits. This risk assessment should be completed at least annually. The department should evaluate and contribute to improving risk management, controls, and governance processes. (Page M-17)
32. The department should base audit plans on both subjective analysis of comments from management and objective analysis of financial and operating data. (Page M-25)
34. Elected officials, their staff, and the City's senior management must be considered by the internal audit function. (Page M-17)

Status: In-process. The long-term plan for completion of the Internal Auditor Kroll remediation items will require a City Charter change. In the meantime, the City has implemented an interim solution. On March 26, 2007 the Mayor filled the position of Internal Auditor on an interim basis. This position will be staffed by Mr. Kyle Elser an existing City employee who has internal audit experience and qualifications. Refer to Attachment C for Mr. Elser's resume.

Additionally, the City has an open job announcement for an Internal Auditor to fill this position with an understanding that the reporting responsibilities of the Internal Audit position may change with City Charter amendments. The interim Internal Auditor will report to the Mayor and will meet with the City's Audit Committee no less than on a quarterly basis and periodically with the City Council as needed and will submit annually to the City Council a public report of his/her activities. Additionally, the Internal Auditor will present to the Audit Committee the results of any investigation and disposition of such complaints. Procedures will be established for reporting to the Audit Committee any information that is prohibited from public disclosure. During the interim period, the Internal Auditor will focus on performing a Citywide Risk Assessment in accordance with the *International Standards for the Professional Practice of Internal Auditing*, and develop audit plans based on the assessment. The assessment will include financial reporting and the City's internal controls over financial reporting.

Remedial Category – Disclosure

50. The City should assign the responsibilities for preparing public documents and filings to the appropriate City employees. Ultimate responsibility for preparing these City documents cannot be assigned to the independent auditor, disclosure counsel, fiduciary counsel, actuary, or other professionals. (Page M-25)
60. City schedules requested by the external auditors should be prepared and internally reviewed before the auditors begin work. As part of a sound financial reporting system, the City should prepare supporting schedules and detail for all major accounts and transactions during the monthly closing process. (Page M-17)

61. The City should report as part of its annual CAFR staff's best estimate of material payments it will be required to make for each of the next five years and in aggregate thereafter, as a result of contractual commitments or other commitments the City reasonably intends to fulfill. This includes expected pension payments, retiree health premium payments, capital expenditures resulting from contractual commitments; material contractual commitments in excess of one year; deferred maintenance to extent qualified; and debt and lease obligations. (Page 254 & M-8)

Status: In-process. Interviews with process owners and documentation of internal controls are occurring.

Remedial Category – Training

91. MWWD employees should receive special training directed at ensuring the City complies with all contractual requirements, laws and regulations and reporting any noncompliance to the appropriate individuals or entities. (Pages 247 & M-2)
92. Tailored training for all individuals who are currently employed by the City who were members of the Metropolitan Wastewater Department at any time from 1995 to 2004, the period of the City's noncompliance with its SWRCB grant and loan covenants and its violation of the Federal Clean Water Act should also be developed. The Metropolitan Wastewater Department employees should receive special training directed at (i) ensuring the City complies with all contractual requirements, laws and regulations, and (ii) reporting any noncompliance to the appropriate individuals or entities. (Pages M-2 to M-3)
93. The City should educate the employees responsible for recording sewer invoices on how to identify the appropriate supporting documentation for Municipal and Metropolitan allocations in order to reduce the likelihood of significant misclassifications. (Page M-22 & M-23)

Status: In-process. Darlene Morrow-Truver, Deputy Director, MWWD, has initiated efforts on Kroll remediation for items 91-93 and is on schedule to complete the items by the established due date of July 2007.

94. Training of City staff and elected officials regarding their disclosure obligations under federal and state securities should be conducted no less frequently than every two years. (Pages 262 & M-13)

Status: In-process. Certain elected officials received disclosure training related to obligations under federal and state securities on March 5, 2007. The training was provided by outside consultant, John McNally of Hawkins Delafield & Wood LLP. In addition, on April 9, 2007, training will be provided by the City's independent auditors, specifically Jim Godsey of Macias Gini and O'Connell.

For City staff a two-part training session will be conducted by Mr. McNally on April 25 and 26, 2007. The session on April 25, 2007 is for Executive Team and Community & Legislative Services staff. The session on April 26, 2007 is in addition to the training on April 25, 2007. The Executive Team and Community & Legislative Services staff are required to attend both sessions. In addition, the April 26, 2007 training session is also for anyone in the

II. Remedial Items In-Process

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departments that directly or indirectly contribute to preparing or reviewing language that becomes part of the City's or an Agency's disclosure, with a particular focus on offering documents.

Appropriate policies and procedures are in the process of being amended to require that disclosure obligations training under federal and state securities be conducted no less frequently than every two years.

III. Timeline Modifications

002071

Due to unanticipated Auditor and Comptroller Office resource requirements related to supporting prior year Comprehensive Annual Financial Reports (CAFRs) audits and due to staffing shortages on the Kroll remediation team, some of the important Kroll remediation items related to financial reporting will not be completed by the due dates stated in my memorandum dated August 24, 2006. At the time my memorandum was issued, the City expected that audited CAFRs for fiscal years 2003-2005 would be issued by February 16, 2007.

The 2003 audited CAFR was not issued until mid March 2007 and the 2004-2005 CAFRs have not been issued to date. Auditor and Comptroller staff resources that were planned to assist with Kroll remediation efforts will not be available until the City is current with audited CAFRs.

Some of the more significant Kroll items impacted by timeline modifications are discussed below.

Remedial Category – Independent Auditors

36. A reputable independent auditing firm should be retained by the City's new Audit Committee which should in connection with the annual audit of the financial statements of the City for the fiscal year ending June 30, 2008, conduct an audit of the City's internal controls (emphasis added). (Pages 248, M-3 & M-4)

Remedial Category – Financial Reporting

58. The Mayor and Chief Financial Officer should annually include in the City's CAFR a signed management report on the financial statements and disclosures which include a statement of the City's responsibility for establishing and maintaining an effective system of internal control over financial reporting and disclosures; a statement setting forth the City's assessment of the effectiveness of the internal controls (emphasis added); a statement that based on their knowledge, the CAFR does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the CAFR not misleading; and a statement that the financial statements and other information included in the CAFR fairly present in all material respects the net assets and activities of the City for the period presented. (Pages 248, 249 & M-4)
59. The chief executive officer and principal accounting officer of each component unit of the City should include annually with its stand alone financial statements a signed management report substantially in the form described for the Mayor and CFO (emphasis added). (Pages 249 & M-4)

Updated Status: Updated status relates to the areas of items 36, 58 and 59 that are underlined above. The audit of internal controls by an independent auditing firm is directly related to City management's assessment of the effectiveness of internal controls. City management believes audit of the City's internal controls by a reputable independent auditing firm should not take place until the City's new Enterprise Resource Planning (ERP) system has been

III. Timeline Modifications

002072

implemented. By the time the ERP system is implemented, the City should be current on audits of its CAFRs and should have sufficient resources to focus on internal controls over financial reporting.

Additionally, the nature and structure of the City's internal controls are anticipated to change (and be enhanced) as a result of ERP implementation. City management believes that documenting and assessing internal controls for the new ERP system will add significantly more value than documenting and assessing internal controls for the current accounting system that is more than 30 years old and is planned to be replaced in the near-term.

Remedial Category – Internal Controls

79. The City has taken a number of steps to quantify the impact and correct its financial statements resulting from deficiencies in internal controls related to capital asset accounting. The City should continue to monitor the internal controls over these areas to ensure that potential errors in the future are detected and corrected in a timely manner. (Page M-20)
80. A number of deficiencies in the internal controls related to accounting for accounts receivable were identified. The City should develop and implement policies and procedures to reconcile, support, and review period end accounts receivable balances. (Page M-21 & M-22)

Updated Status: The original completion date of June 2007 will not be met for full remediation of these items. Kroll items 79 (capital asset accounting) and 80 (accounts receivable reconciliations) both contain numerous subprocesses which are being prioritized based upon internal control importance.

The City's capital asset accounting process resulted in 20 restatements to the CAFR for the fiscal year ended June 30, 2003. As a result, this area requires more attention and therefore more documentation than other areas.

The City's accounts receivable balance is comprised of data from many different sub-systems. Each sub-system may require a unique reconciliation process which translates into documenting more subprocesses.

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Experience

City of San Diego Auditor & Comptroller, San Diego, CA

Financial Operations Manager

5/2006-Present

I am the Principal executive responsible for the operations of the Comptroller division of the Auditor & Comptroller's office. My responsibilities include accounts payable, comptroller systems, capital asset accounting, debt accounting, fund analysis, redevelopment accounting and financial reporting. During this time I have been responsible for direct oversight of the production of City's Comprehensive Annual Financial Report, including the successful completion of the City's 2003 CAFR. This report was delayed as a result of numerous political, legal and compliance challenges facing the City. These challenges were related to the under funding of the City's pension system and misappropriation of enterprise fund assets which took place over a period of approximately 20 years.

- Directly supervise eight Principal Accountants and indirectly supervise 65 employees
- Oversaw the implementation of a financial reporting system.

Principal Accountant

5/2005-5/2006-

Working under the Auditor & Comptroller, I was responsible for the oversight and management of the Audit and Systems divisions of the City of San Diego. My responsibilities included, revenue auditing, internal auditing, performance auditing and the implementation of a data warehouse. In this capacity, I oversaw the production of the Auditor and Comptroller's First Annual Report on Internal Controls. This report was a comprehensive citywide risk assessment of financial reporting controls using the COSO framework. The report was a foundation for remediation efforts related to correcting the financial reporting irregularities previously experienced by the City.

- Directly supervised three Principal Accountants and indirectly supervised 14 employees.

Santa Barbara County Auditor-Controller, Santa Barbara, CA

Accountant - Auditor 3

3/2004-5/2005

- Overseeing junior staff on audits and reviewing their work.
- Performing financial, operational and compliance audits.
 - Performing internal control reviews.
 - Preparing audit and review reports.
 - Planning and developing audit and review methodologies.

Accountant - Auditor 2

9/2003-3/2004

- Performing financial, operational and compliance audits.
 - Performing internal control reviews.
 - Preparing audit and review reports.

Accountant - Auditor 1

8/2002-9/2003

- Performing financial, operational and compliance audits.

UCSB, Santa Barbara, CA

Information Systems Analyst

4/2001-4/2002

- Providing technical support to administrative staff.
- Researching and evaluating hardware and software applications.
- Providing technical support for desktops, server applications and hardware.
- Installing network and server components.
- Creating illustrations and schematics of the Facilities Fiber Optic Network.

References and additional experience are available upon request

Korn/Ferry Futurestep, Sherman Oaks, CA

Project Analyst

6/1999-4/2001

- Implementing and Managing communications server and database of 700,000 candidates.
- Working as Community Events Manager (Discussion Boards and Chats).
- Performing quality assurance on corporate and client websites.
- Technical liaison between retention marketing group and IT department.

Education

Bachelor of Arts - Business Economics - Accounting

University of California at Santa Barbara

Coursework included Accounting, Monetary Economics, Personnel Economics and Finance.

Certifications & Other Experience

Certified Public Accountant, State of California License #90699
CPR certified

Outward Bound

Colorado School of Leadership and Survival Training

- 21-day wilderness leadership course

Skills

G/L accounting, Cost Accounting and Compliance Review, Financial Reporting Budget and GAAP, Microsoft Word, Excel, Access, Adobe Photoshop, Paint Shop Pro, Adobe Illustrator, Internet Proficient, MS Outlook Enterprise Email Software, Basic HTML, NT 4.0 Server Management

Recent Training

Completed continuing professional education in the following areas:

Bisk:

Internal Control and Fraud in Government Engagements 8/2006

GFOA:

GASB review 1/2006

Satellite Update 11/2004

Satellite Update 4/2004

IIA:

Sarbanes-Oxley: Process Improvement Workshop 8/2005

Sarbanes-Oxley Primer: Charting Your Course 6/2005

TRACY M MCCRANER(760)599- 0936 tmccraner@sandiego.gov**OBJECTIVE**

A senior management accounting position with a large governmental entity focusing on financial reporting and analysis

PROFESSIONAL EXPERIENCE

- 2006 – present City of San Diego-Auditor and Comptroller's Office
Principal Accountant-CAFR/Accounting Operations
- Assigned as project manager to lead the CAFR team in the completion of the City's 2003 CAFR audit by KPMG, as well as the FY 2004 and 2005 CAFR audits with Macias Gini. Lead approximately 10 professional staff to ensure the completion of the City's 2003 annual report while also maintaining the continued progress of the City's 2004 and 2005 audits.
 - Managed approximately 17 staff within the Accounting Operations and Accounts Payable sections of the Auditors office. This team was responsible for centralizing all payment review and approval processes city-wide, and successfully decreased payment turnaround times from a 5 day average to a 2 day average within 6 months of implementation.
- 2001-2006 City of San Diego-Auditor and Comptroller's Office
Principal Accountant-Accounting Operations/CIP/Cost
- Managed 8-12 accountants and 4-7 account audit clerks. Reviewed daily, monthly and year end work, financial statements, interim statements, coordinated staff activities, and prepared annual and probationary performance evaluations.
 - Responsible for the coordination and compilation of the City's Comprehensive Annual Financial Report (CAFR) for fiscal years (FY) ending June 30 2003, 2004 and 2005.
 - GASB 34 implementation team member, ensured June 30, 2002 CAFR was in compliance with all GASB 34 requirements related to capitalization of infrastructure, depreciation on governmental assets, and long term liability adjustments to governmental debt. Was responsible for the hiring of outside consultant to assist in the valuation of all city-owned infrastructure and lead a team of City departments to ensure accurate reporting of all infrastructure assets.
 - Supervised the preparation of the General Fund revenue and expenditure analysis, provided monthly reports to the City Manager/Mayor and City Council.
 - Supervised the accountants in charge of General Fund, TOT, Emergency Medical Services, Public Liability, and Capital Improvements Program (CIP) budgets.

- Responsible for the oversight and approval of the calculation of the City's departmental and federal overhead rates, and central service department billings to Enterprise funds for FY 2001 through 2006.
- Oversight of the transportation and park and recreation grant program.
- Oversight and review of the preparation of the Annual Streets, Tidelands and State Controller's Reports for fiscal years 2001, 2002 and 2003.

1999-2001

City of San Diego-Auditor and Comptroller's Office
Accountant IV-Accounting Operations/CIP/Cost

- Managed 3-4 accountants and one account audit clerk. Reviewed all daily, monthly and year end work, financial statements and interim reports. Prepare staff performance plans and evaluations.
- Managed the compilation of the City's CAFR for fiscal year ending June 30, 1999. Coordinated weekly meetings with outside auditors, managed staff responsible for financials and footnote preparation.
- Responsible for the CIP budgets of all governmental projects city-wide, fund certification, project maintenance, capitalizations, etc.
- Responsible for first line review of the General Fund monthly revenue and expenditure analysis.
- Responsible for the Capital Projects and Debt Service sections of the CAFR for FY 2000 and 2001.
- Responsible for the City's blended component unit financial statements for the Facilities Equipment Leasing Corporation, Open Space Park Facilities District, Convention Center Corporation and Public Facilities Financing Authority.

1995-1999

City of San Diego-Auditor and Comptroller's Office
Accountant III-CIP Cost Section

- Supervised 2 accountants and one account audit clerk, immediate supervision, daily hands on reviewer, provided input to performance evaluations to Accountant IV.
- Implementation team member for the new Fixed Asset Management System (FAMIS) and was responsible for overseeing the transition and reconciliation of all governmental asset data from the old fixed asset system to FAMIS.
- Responsible for the compilation of the General Fixed Asset Account Group (GFAAG) for CAFR's FY 1995-1999.
- Responsible for the Capital Outlay, Police Decentralization and bond funds for FY 1995-1999.
- Responsible for the buildings and improvements for all City of San Diego governmental projects, and related CIP budgets.
- Responsible for the special assessment debt funds for the City.

1988-1995

City of San Diego-Auditor and Comptroller's Office
Accountant

- Prepared the General Fund revenue and expenditure analysis.
- Responsible for the General Fund payments, Council Actions, Manager Actions and budget adjustments and year end financial statement preparation.
- Responsible for all Mayor and Council department analysis, data processing projections and special fund budgets.
- Responsible for all out of town travel and in town meetings expense review and monthly and quarterly reports to Council.

EDUCATION

San Diego State University: Bachelor of Science Degree in Accounting

References available upon request.

Kyle S. Elser, CPA, CIA
Work (619) 235-5805, Email: KElser@sandiego.gov

PROFESSIONAL EXPERIENCE

City of San Diego

Payroll Manager (Principal Accountant) Oct 2005 - Present

- ◆ Supervise eight staff members responsible for administering the City of San Diego's biweekly payroll, quarterly payroll tax returns and annual W-2 Forms.

Internal Audit Supervisor (Principal Accountant) Jan 2001 - Oct 2005

- ◆ Assisted in the development of the annual audit plan for the internal audit section.
- ◆ Supervised eight staff members in performing the internal audit plan.
- ◆ Reviewed workpapers and prepare audit reports for the Audit Division Manager's signature.
- ◆ Performed various audits and other projects while supervising internal audit section.

Internal Auditor (Accountant II, Accountant III) Aug 1996 - Jan 2001

- ◆ Performed internal audits to determine Departments' compliance with laws and regulations.
- ◆ Reviewed internal controls to ensure City assets were properly utilized and safeguarded.
- ◆ Made recommendations to correct internal control weaknesses identified.
- ◆ Performed contract compliance audits with the various City vendors and City agencies.
- ◆ Performed operational audits and made recommendations to increase process efficiencies.
- ◆ Performed audits to ensure City Departments were accurately reporting annual performance measures.

External Revenue Auditor (Accountant Trainee, Accountant I) Jan 1995 - Aug 1996

- ◆ Performed hotel tax, franchise tax, business license tax, and rental unit tax audits.

Kornfeld & Levy, CPA's

Accountant Feb 1988 - Jan 1995

- ◆ Performed professional accounting work preparing full disclosure financial statements.
- ◆ Prepared corporate, partnership, individual and payroll tax returns.

EDUCATION

Humboldt State University

Graduated May 1987

B. S., Business Administration, Emphasis: Accounting
Special Minor: Speech Communication

CERTIFICATIONS

- ◆ Received Certified Public Accountant certification April 1999.
- ◆ Received Certified Internal Auditor certification May 1998.

002081

Prepared by: Lisa Gordon
 Cell #: (619) 846-4659
 Security Detail: Odie Gallop
 Cell #: (619) 980-0490

EVENT ADVANCE FORM

Retirement Celebration for Scott Fulkerson
Executive Director, Citizens' Review Board on Police Practices
Tuesday, August 28, 2007
6 p.m. – 8 p.m.

Mayor Arrives: 6:00 p.m.

Mayor Departs: 6:45 p.m.

EVENT DESCRIPTION: (Provide information about event)	Retirement Celebration for Scott Fulkerson, Executive Director for the Citizens' Review Board on Police Practices (CRBPP), for 22 years of service to the City of San Diego
LOCATION: (Business name & address)	Point Loma/Hervey Branch Public Library – Community Room 3701 Voltaire Street San Diego, CA 92107 (619) 531-1539
POINT OF CONTACT: (Office and Cell)	Jim Dort Home: (858) 274-5189 Cell: (619) 733-1060
MAYOR'S ROLE:	Presenting Proclamation at 6:15 p.m. Lisa Gordon will bring Proclamation.
PROGRAM:	At 6:15 p.m. Jim Dort, Chair of CRBPP, will introduce Mayor. Other speakers will follow including Chief Lansdowne, Bill Nemec (President, Police Officers Assoc.) Patrick Hunter (new Exec. Director of CRBPP), Sandra Arkin (CRBPP Board Member)-Reading of Proclamation from Senator Kehoe. Final speaker: Scott Fulkerson. Reception follows (hors d'oeuvres and beverages).
OTHER INFORMATION:	Ample parking adjacent to building.
ATTIRE:	Business Attire
ATTENDEES/VIP'S:	85 expected. Various Police Captains and Lieutenants will attend.
COST TO ATTEND: (Face value of ticket / Open to public?)	N/A
TABLE/SEAT SPONSOR:	N/A
SEATED WITH:	N/A
STAFF: CELL #:	Lisa Gordon (619) 846-4659
ATTACHMENTS:	Retirement Celebration Invitation, Map

002082

Prepared by: Staci Ignell
 CC: Kris Michell
 Cell #: (858) 442-6568
 Security Detail: Tony Lessa
 Cell #: (619) 980-4557

EVENT ADVANCE FORM

Unveiling of Governor Pete Wilson Statue and Reception
Horton Plaza
August 25, 2007

Mayor Arrives: 4:00PM

Mayor Departs: Approx 7:00PM (or at discretion)

EVENT:	Unveiling of Governor Pete Wilson Statue and Reception
LOCATION: (Business name & address)	Unveiling: Near NBC Building – Horton Plaza Reception: Westgate Hotel, 3 rd Floor
POINT OF CONTACT: (Office and Cell)	Karolyn Dorsee (619) 990-9212 cell Governor Pete Wilson (310) 418-8911 cell
DESCRIPTION/ MAYOR'S ROLE:	The Mayor will be seated on stage during the unveiling program. The Mayor will give a brief welcome to attendees at reception.
PROGRAM:	3:35PM – Mayor Arrives w/ Governor Wilson (CCDC Showroom) Greeted by Karolyn Dorsee, John Davies & Jim Mulvaney 3:55PM – Mayor and Governor take stage 4:00PM – Welcoming Remarks by Roger Hedgecock 4:05PM – Entertainment by Club 33 Rotarians (singing) 4:10PM – Roger Hedgecock introduces elected officials 4:15PM – Steve Williams speaks, followed by Herb Klein 4:25PM – Herb Klein introduces Governor Wilson 4:35PM – Champagne toast by Jim Mulvaney (Committee Chair) 4:45PM – Unveiling of Statue (Gayle Wilson to untie bow) 5:00PM – Travel to Westgate/Reception Begins 6:15PM – Mark Larson Introduces Mayor Sanders Mayor to make welcome remarks/leaves stage 6:20PM – Mark Larson introduces Sheriff Bill Kolender Kolender introduces Governor Wilson Gayle leads "Happy Birthday" Cake Ceremony 8:00PM – Event Concludes (approximately) (Mayor is free to leave at his discretion)
OTHER INFORMATION:	Other elected officials on stage: Supervisor Greg Cox, Sheriff Bill Kolender, DA Bonnie Dumanis, Mayor Cheryl Cox, Councilmember Kevin Faulconer

<p>002083</p> <p>ATTENDEES/VIP'S:</p>	<p>Congressman Darrell Issa Senator Mark Wyland Assemblymember Martin Garrick Assemblymember George Plescia Assemblymember Shirley Horton Supervisor Greg Cox (stage) Supervisor Dianne Jacob Sheriff Bill Kolender (stage) District Attorney Bonnie Dumanis (stage) San Diego Mayor Jerry Sanders (stage) Chula Vista Mayor Cheryl Cox (stage) Escondido Mayor Lori Holt Pfeiler La Mesa Mayor Art Madrid San Diego City Attorney Mike Aguirre San Diego Councilmember Kevin Faulconer (stage) San Diego Councilmember Jim Madaffer Republican Party State Chair Ron Nehring Republican Party of San Diego County Chair Tony Kravaric Mary Buckman, Statue Artist Lane Campbell, Fire Art Foundry for the Statue</p>
<p>STAFF: CELL #:</p>	<p>Kris Michell (858) 232-2380</p>
<p>COST/TICKETED:</p>	<p>\$50.00/ticketed event/mayor speaking</p>

002084

Prepared by: Staci Ignell
 CC: Kris Michell
 Cell #: (858) 442-6568
 Security Detail: Tony Lessa
 Cell #: (619) 980-4557

EVENT ADVANCE FORM

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 Horton Plaza
 August 25, 2007**

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Mayor Departs: Approx 7:00PM (or at discretion)

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POINT OF CONTACT: (Office and Cell)	Karolyn Dorsee (619) 990-9212 cell Governor Pete Wilson (310) 418-8911 cell
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OTHER INFORMATION:	Other elected officials on stage: Supervisor Greg Cox, Sheriff Bill Kolender, DA Bonnie Dumanis, Mayor Cheryl Cox, Councilmember Kevin Faulconer

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ATTENDEES/VIP'S:	Congressman Darrell Issa Senator Mark Wyland Assemblymember Martin Garrick Assemblymember George Plescia Assemblymember Shirley Horton Supervisor Greg Cox (stage) Supervisor Dianne Jacob Sheriff Bill Kolender (stage) District Attorney Bonnie Dumanis (stage) San Diego Mayor Jerry Sanders (stage) Chula Vista Mayor Cheryl Cox (stage) Escondido Mayor Lori Holt Pfeiler La Mesa Mayor Art Madrid San Diego City Attorney Mike Aguirre San Diego Councilmember Kevin Faulconer (stage) San Diego Councilmember Jim Madaffer Republican Party State Chair Ron Nehring Republican Party of San Diego County Chair Tony Kravaric Mary Buckman, Statue Artist Lane Campbell, Fire Art Foundry for the Statue
STAFF: CELL #:	Kris Michell (858) 232-2380
COST/TICKETED:	\$50.00/ticketed event/mayor speaking

Prepared by: Staci Ignell
 CC: Kris Michell
 Cell #: (858) 442-6568
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EVENT ADVANCE FORM

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OTHER INFORMATION:	Other elected officials on stage: Supervisor Greg Cox, Sheriff Bill Kolender, DA Bonnie Dumanis, Mayor Cheryl Cox, Councilmember Kevin Faulconer

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ATTENDEES/VIP'S:	Congressman Darrell Issa Senator Mark Wyland Assemblymember Martin Garrick Assemblymember George Plescia Assemblymember Shirley Horton Supervisor Greg Cox (stage) Supervisor Dianne Jacob Sheriff Bill Kolender (stage) District Attorney Bonnie Dumanis (stage) San Diego Mayor Jerry Sanders (stage) Chula Vista Mayor Cheryl Cox (stage) Escondido Mayor Lori Holt Pfeiler La Mesa Mayor Art Madrid San Diego City Attorney Mike Aguirre San Diego Councilmember Kevin Faulconer (stage) San Diego Councilmember Jim Madaffer Republican Party State Chair Ron Nehring Republican Party of San Diego County Chair Tony Kravaric Mary Buckman, Statue Artist Lane Campbell, Fire Art Foundry for the Statue
STAFF: CELL #:	Kris Michell (858) 232-2380
COST/TICKETED:	\$50.00/ticketed event/mayor speaking

002088

Prepared by: Staci Ignell
 CC: Kris Michell
 Cell #: (858) 442-6568
 Security Detail: Tony Lessa
 Cell #: (619) 980-4557

EVENT ADVANCE FORM

Unveiling of Governor Pete Wilson Statue and Reception
Horton Plaza
August 25, 2007

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Mayor Departs: Approx 7:00PM (or at discretion)

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POINT OF CONTACT: (Office and Cell)	Karolyn Dorsee (619) 990-9212 cell Governor Pete Wilson (310) 418-8911 cell
DESCRIPTION/ MAYOR'S ROLE:	The Mayor will be seated on stage during the unveiling program. The Mayor will give a brief welcome to attendees at reception.
PROGRAM:	8:35PM – Mayor Arrives w/ Governor Wilson (CCDC Showroom) Greeted by Karolyn Dorsee, John Davies & Jim Mulvaney 8:55PM – Mayor and Governor take stage 4:00PM – Welcoming Remarks by Roger Hedgecock 4:05PM – Entertainment by Club 33 Rotarians (singing) 4:10PM – Roger Hedgecock introduces elected officials 4:15PM – Steve Williams speaks, followed by Herb Klein 4:25PM – Herb Klein introduces Governor Wilson 4:35PM – Champagne toast by Jim Mulvaney (Committee Chair) 4:45PM – Unveiling of Statue (Gayle Wilson to untie bow) 5:00PM – Travel to Westgate/Reception Begins 6:15PM – Mark Larson Introduces Mayor Sanders Mayor to make welcome remarks/leaves stage 6:20PM – Mark Larson introduces Sheriff Bill Kolender Kolender introduces Governor Wilson Gayle leads "Happy Birthday" Cake Ceremony 8:00PM – Event Concludes (approximately) (Mayor is free to leave at his discretion)
OTHER INFORMATION:	Other elected officials on stage: Supervisor Greg Cox, Sheriff Bill Kolender, DA Bonnie Dumanis, Mayor Cheryl Cox, Councilmember Kevin Faulconer

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ATTENDEES/VIP'S:	Congressman Darrell Issa Senator Mark Wyland Assemblymember Martin Garrick Assemblymember George Plescia Assemblymember Shirley Horton Supervisor Greg Cox (stage) Supervisor Dianne Jacob Sheriff Bill Kolender (stage) District Attorney Bonnie Dumanis (stage) San Diego Mayor Jerry Sanders (stage) Chula Vista Mayor Cheryl Cox (stage) Escondido Mayor Lori Holt Pfeiler La Mesa Mayor Art Madrid San Diego City Attorney Mike Aguirre San Diego Councilmember Kevin Faulconer (stage) San Diego Councilmember Jim Madaffer Republican Party State Chair Ron Nehring Republican Party of San Diego County Chair Tony Kravaric Mary Buckman, Statue Artist Lane Campbell, Fire Art Foundry for the Statue
STAFF: CELL #:	Kris Michell (858) 232-2380
COST/TICKETED:	\$50.00/ticketed event/mayor speaking

City of San Diego Audit Committee Charter

Purpose

The purpose of the Audit Committee (the "Committee") of the City Council (the "Council") of the City of San Diego (the "City") is to:

- Provide independent, legislative oversight of the City's accounting and financial reporting processes, financial internal controls, internal financial audit function and audits of the City's financial statements;
- Assist the Council in performing its legislative oversight function in those areas;
- Review the financial reports and other financial information provided by the City, the City's disclosure controls and procedures, and its internal financial controls;
- Consider the reports of and interact with the City's internal auditor in connection with the internal auditor's performance of an independent internal financial audit function;
- Assume direct responsibility, with appropriate consultation with the Mayor or his designee (the "Mayor"), for the appointment, compensation, retention and where appropriate, replacement of the outside auditor to the City in preparing or issuing an audit report or related work;
- Oversee the work and independence of the outside auditor, approve all auditing services and permitted non-audit services provided by the outside auditor, and resolve any disagreements between the Mayor and the outside auditor regarding financial reporting; and
- Carry out the specific responsibilities set forth below in furtherance of this stated purpose.

Committee Membership and Procedures

Committee members shall be appointed in accordance with the Council Procedures.

The Committee shall be comprised of three voting Council members. The terms of the members, whenever possible, shall be arranged to ensure that there is always at least one experienced member of the Committee.

The Committee shall meet periodically as it determines. It shall conduct its meetings in accordance with this Charter, the procedures of the Council, the requirements of California law and such other lawful procedures as the Committee may adopt. The Committee may, consistent with California law, meet in executive session when determined necessary, including for personnel matters.

Resources

The Committee shall be advised, from time-to-time, by an ad hoc advisory committee, created and established only for the purpose of advising on questions with clearly defined objectives, and shall be temporary in nature, and shall be dissolved upon the completion of the objectives for which the advisory committee was created. The advisory committee shall consist of three members, one member who shall be appointed by the Mayor, and two members who shall be appointed by the Committee. The advisory committee members shall be citizens selected for their accounting or audit expertise or financial management expertise. Each of the members shall serve without compensation.

The Committee may, from time to time, retain professional consultants as it considers necessary to carry out its functions. The Committee shall be provided with appropriate funding, as determined by the Committee and approved by the City Council, for payment of compensation to any such consultants and advisors and any outside auditor, as well as for any ordinary administrative expenses of the Committee that it determines are necessary or appropriate in carrying out its responsibilities.

Complaint Procedures

Any issue of significant financial misconduct shall be brought to the attention of the Committee for its consideration. In this connection, the Committee shall establish procedures for (i) the receipt, retention and treatment of complaints received by the City regarding internal financial controls or financial auditing matters and (ii) the confidential, anonymous submission by employees of the City of concerns regarding questionable financial or auditing matters.

Key Responsibilities

The Committee's role is one of oversight, and it is recognized that the Mayor is responsible for preparing the City's financial statements and that the outside auditor, which is ultimately accountable to the Committee, is responsible for auditing those financial statements.

The following functions shall be the common recurring activities of the Committee in carrying out its oversight role. The functions are set forth as a guide and may be varied and supplemented from time to time as appropriate under the circumstances.

Appointment of Outside Auditor. The Committee shall have direct responsibility, with appropriate consultation with the Mayor, for the appointment, compensation, retention and where appropriate, replacement of any registered public accounting firm selected to be the City's outside auditor for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the City. The Committee shall provide oversight of the work of the outside auditor and, consistent with the requirements of the City Charter and California law, may meet with the outside auditor outside the presence of the Mayor to discuss the audit and the City's fiscal affairs.

Disclosure Controls and Procedures. The Committee shall review periodically with the Disclosure Practices Working Group and the Mayor the City's disclosure controls and procedures, and shall review and evaluate the annual report on the City's disclosure controls and procedures made by the Disclosure Practices Working Group and provide to the Disclosure Practices Working Group, the Mayor, and the City Council any comments or recommendations it may have.

Internal Controls. The Committee shall discuss periodically with the Mayor and the outside auditor the quality and adequacy of the City's internal controls over financial reporting and internal financial auditing procedures, including any significant deficiencies or material weaknesses in the design or operation of those controls which could adversely affect the City's ability to record, process, summarize or report financial data and any fraud, whether or not material, that involves the Mayor or other employees who have a significant role in the City's financial internal controls, and discuss with the outside auditor how the City's financial systems and controls compare with practices in the municipal sector.

Internal Auditing. The Committee shall, in a manner consistent with paragraph 2 of the Statement of Operating Principles issued by the Mayor, make recommendations, along with the City Council, the Mayor, and the City Attorney, for matters to be included in the Annual Audit Work Plan developed by the internal auditor as part of the internal audit function, recognizing the need to prioritize workload according to available resources, budget and critical needs. The Committee shall review and comment on the Annual Audit Work Plan and monitor its progress on at least a quarterly basis. The Committee shall review the results of internal financial audits and monitor the follow-up on recommendations. Consistent with the requirements of the City Charter and California law, the Committee may meet with the internal auditor outside the presence of the Mayor to discuss the internal financial audit.

Accounting Policies. The Committee shall review periodically with the Mayor and the outside auditor the quality, as well as acceptability, of the City's accounting policies, and discuss with the outside auditor how the City's accounting policies compare with those in the municipal sector and all alternative treatments of financial information within generally accepted accounting principles that have been discussed with the Mayor, the ramifications of use of such alternative disclosures and treatments and the treatment preferred by the outside auditor.

Pre-approval of All Audit Services and Permitted Non-Audit Services. The Committee shall approve, or establish procedures for representatives of the Committee to approve, in advance, all audit services and all permitted non-audit services to be provided to the City by the outside auditor in order to ensure the outside auditor's independence.

Annual Audit. In connection with the annual audit of the City's financial statements, the Committee shall:

- request from the outside auditor a formal written statement delineating all relationships between the outside auditor and the City consistent with Independence Standards Board Standard No. 1 and any other applicable auditing requirements, discuss with the outside auditor any such disclosed relationships and their impact on the outside auditor's objectivity and independence, and take appropriate action to oversee the independence of the outside auditor.
- approve, after appropriate consultation with the Mayor, the selection and the terms of the engagement of the outside auditor.
- review with the Mayor and the outside auditor the audited financial statements to be included in the City's Comprehensive Annual Financial Report, and provide to the Mayor any comments or recommendations it may have, and review and consider with the outside auditor the matters required to be discussed by Statement on Auditing Standards No. 61.
- perform the procedures set forth below in "*Financial Reporting Procedures*" with respect to the annual financial statements to be reported.
- review with the Mayor and the outside auditor the City's critical accounting policies and practices.
- recommend to the Council whether, based on the reviews and discussions referred to above, the annual financial statements should be issued by the City.

Continuing Reporting. In connection with the City's preparation of its continuing reporting of financial information, the Committee shall:

- review the City's financial information to be included in the City's continuing reports, and discuss them with the Mayor and, to the extent appropriate, the outside auditor.
- perform the procedures set forth below in "*Financial Reporting Procedures*" with respect to the financial information to be included in the continuing reports.

Financial Reporting Procedures. In connection with the Committee's review of each reporting of the City's annual or continuing financial information, the Committee shall:

- discuss with the outside auditor, to the extent appropriate, whether all material correcting adjustments identified by the outside auditor in accordance with generally accepted accounting principles are reflected in the City's financial statements.
- review with the outside auditor all material communications between the outside auditor and the Mayor, such as any letter or schedule of unadjusted differences.
- review with the Mayor and the outside auditor any material financial or other arrangements of the City which do not appear on the City's financial statements and any transactions or courses of dealing with third parties that are significant in size or involve terms or other aspects that differ from those that would likely be negotiated with independent parties, and which arrangements or transactions are relevant to an understanding of the City's financial statements.
- resolve any disagreements between the Mayor and the outside auditor regarding financial reporting.

Securities Law Compliance. The Committee shall review and evaluate the City's compliance with its obligations under federal and state securities laws with respect to securities issued by the City and by the "related entities," as defined in San Diego Municipal Code section 22.1702, and provide to the Disclosure Practices Working Group, the Mayor, and the City Council any comments or recommendations it may have.

Coordination. The Committee shall work to assure maximum coordination between the work of the internal auditor, the Council as legislative body and the outside auditor.

Charter. The Committee shall review and reassess at least annually the adequacy of this Charter and recommend any proposed changes to the Council for approval.